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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
MONDAY
APRIL 24, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D., - CHAIRMAN

HAROLD ADAMS INNIS - COMMISSIONER

HENRY FORBES ANGUS - COMMISSIONER

G.R. Hunter
Secretary

P.L. Belcourt
Asst. Secretary

COUNSEL APPEARING:-

F.M. Covert, K.C. G.C. Desmarais, K.C.	Royal Commission on Transportation
H.E. O'Donnell, K.C. N.J. MacMillan H.C. Friel, K.C.	Canadian National Railways
C.F.H. Carson, K.C. F.C.S. Evans, K.C. K.D.M. Spence I.D. Sinclair	Canadian Pacific Railway
C.W. Brazier	Province of British Columbia
J.J. Frawley, K.C.	Province of Alberta
M.A. MacPherson, K.C.	Province of Saskatchewan
C.D. Shepard	Province of Manitoba
J. Paul Barry	Province of New Brunswick
Frank D. Smith, K.C.	Province of Nova Scotia

Ottawa, Ontario
Monday, April 24, 1950.

MORNING SESSION

MR. ALLEN NORTHEY JONES - Recalled

EXAMINATION BY MR. CARSON - (Cont.)

Q. Mr. Jones, your statement had pointed out at the bottom of page 6 and the top of page 7 that to furnish improved service and to be able to off-set some of the increased costs of labour and materials, it is necessary to make improvements, additions and betterments to the property and to find the money to make such improvements. You had mentioned some items following that, such as diesels, the reduction of grades, and so on, and then, as an illustration, your inspection trip over the Atlantic Coast Line Railroad Company, with the President, and the savings in costs that Company had achieved by the purchase of diesels. That brought you down to the bottom of page 7. Will you proceed from there, Mr. Jones?

A. My lord, I should like to interject there an excerpt from a clipping from the Financial Post, which shows that here in Canada also you are turning to diesel power. This article from the Financial Post of last week says, in the headline, "Deliver First Diesel Loco's on C.N.R. Order", and reads in part as follows:-

> "First two units of an order for eight new fifteen-hundred horse-power diesel-electric road locomotives, were delivered last week to the C.N.R. by Montreal Locomotive Works Limited."

Then skipping a few lines, the article goes on to say:-

> "Trend toward diesels, plus reduced

overseas orders, have changed the pattern of operations at the Montreal Locomotive Longue Pointe plant. Last year, 30% of output was diesel, 70% steam. Executive Vice-President Sir Frederick Carson estimates that the ratio will be more than reversed this year, with diesels accounting for 90% of output and steam only 10%.

In addition to the C.N.R. order, the Company has been working on an order from C.P.R. for forty fifteen-hundred horse-power road diesels of the same type and four fifteen-hundred horse-power road switchers. Company had a backlog of unfilled orders totalling $14 millions late in March."

THE CHAIRMAN: Q. What is the date of that clipping?

A. That is from last Friday's Financial Post, April 21.

To go on with the statement:-

I am not a diesel salesman, but I merely present the case of the Atlantic Coast Lines as an example of the type of thing that can be accomplished by a railroad which had poor operating results and deficits in the 30's if it can secure capital to spend on modernization of its power to haul the volume of traffic now available for shipment by rail.

In 1949 railroads in the United States ordered only 13 steam locomotives but ordered 1,699 diesel units, Over the years, American Locomotive Company and Baldwin have been the largest producers of steam locomotives in

the U.S. American Locomotive has completely given up the manufacture of steam locomotives and the only steam locomotives that Baldwin now has on order are for overseas or industrial use. The trend to diesel power, although very important to the railroads of the U.S., is not the only modernization step being undertaken. There are many others, but it must be remembered that these steps all cost money.

Where can the money for modernization and the acquisition of these items which increase efficiency and tend to reduce unit costs come from in the case of railroads in the U.S. or in the case of the investor-owned railroad in Canada? It can come and should come from three sources, namely; (1) depreciation retained from traffic revenues, (2) a portion of the net earnings not distributed to the owners in the form of dividends, usually referred to as retained earnings, and (3) new and additional capital furnished by investors through the purchase of railroad securities.

Although in the Twenty Per Cent Freight Rate Case, Mr. MacPherson of the Province of Saskatchewan questioned my competency to testify as to the inadequacy of sums reserved from earnings for depreciation on old lower cost equipment to meet the cost of replacement with new higher cost equipment, he did not object when I pointed out that the investment banker is often called upon to raise the money necessary to fill the gap between the moneys available from depreciation reserves and replacement costs. I am neither an engineer nor an accountant, and in the Twenty Per Cent Freight Rate Case did not, nor shall I now, attempt to measure quantitatively the extent of that gap. While I realize that the measure of the gap is not the difference in the cost of the new item and the

cost of the itmm replaced where technological advances result in the new item being capable of doing more work and giving better performances than the old item, nevertheless, it seems to me that it is evident on its face that traditional depreciation accounting designed to restore only the original cost of items of property acquired in the past at costs much less than present costs will not pay for their replacement with modern items of property acquired at today's much higher dollar costs. If then this reasoning is sound, the first of the three sources of funds, namely, depreciation retained from traffic revenues, is not even sufficient to replace items of property as they wear out or become obsolete, much less is it sufficient to provide those new, modern and additional items of property that will enable the railroads to give more efficient transportation service at lower cost to themselves and so better meet the competition of other types of carriers and, in the case of the Canadian Pacific, obtain a larger share than otherwise of Canada's expanding traffic.

If source one can be relied upon for only a fraction of the sums needed, we must turn to the other two sources, namely, "retained earnings" and "new capital furnished by investors". What then is necessary that funds shall be available from "retained earnings" and from "new capital furnished by investors"?

For funds to be available from "retained earnings" and from "new capital furnished by investors" it is necessary that an enterprise such as the Canadian Pacific should have a satisfactory "earning power" from rail operations and, in addition, if there is to be investor confidence in the enterprise so that investors will furnish new capital on

reasonable terms, investors must have the belief that the earning power is not and will not be in serious jeopardy. I mean by satisfactory earning power than an enterprise such as the Canadian Pacific must have sufficient rail income to cover rail operating expenses, to cover interest and other fixed charges such as rents, and to cover a fair dividend on preference and common stock, with a surplus to retain and reinvest in the property. It is evident that, if "retained earnings" are to be a source of funds to spend for additions and betterments, there must be earnings in excess of operating expenses and fixed charges which can be retained. Furthermore, in an investor-owned enterprise, if retained earnings are to furnish more than a nominal amount of capital for improvement and expension, the earning power of the enterprise must be such that reasonable dividends can be and are paid for as soon as earnings exceed operating expenses and fixed charges by more than a nominal amount, the investor will demand, and should receive, dividends. It is one of the functions of directors to exercise careful judgment to determine the amounts of net earnings which are to be declared in dividends and the remaining amounts of net earnings which are to be retained for investment in the enterprise.

(Page20430 follows)

This second source of funds, namely 'retained earnings', however, is limited in amount. While fairly substantial amounts of earnings have been retained in the past ten years, both by the railroads in the United States and by the Canadian Pacific, most of these amounts were retained during the war years, when they were devoted to debt reduction largely because materials and labour were not available for railroad improvements and in many cases such earnings were only made available by not paying dividends or paying very low dividends. Since the war, the amount of railway earnings available for retention has declined in the case of the United States railroads and has become non-existent in the case of the Canadian Pacific Railway. The theory of rate making here in Canada has been that there should be some excess of earnings over reasonable dividend requirements of the Canadian Pacific Railway that could be used for additions and betterments and to come and go on, although in practice the lag of rate increases to offset increases in wage and material costs has been such that there has been a deficit of railway earnings, and there I might say a deficit in respect to the dividends which were paid. It would seem that with the large annual expenditures for replacements and additions and betterments that are advisable, retained earnings could not be expected to fill the gap completely between depreciation and the amount that should be spent for such replacements and additions and betterments. If, then, source (1), "depreciation reserved from revenues" is insufficient even for replacements, and source (2), "retained earnings", is insufficient to fill the gap between funds available through depreciation and the cost of replacements and desirable additions and betterments, we must look to

source (3), "new capital furnished by investors", for a substantial portion of the necessary funds.

Before discussing the possibility and practicability of attracting "new and additional capital from investors" let us look at the record in the past nine years (1940-48) for Class I railroads in the United States and for the Canadian Pacific as to capital expenditures for replacements, additions and betterments and as to the funds available from (1) depreciation retained from traffic revenues, (2) retained earnings, and (3) securities sold.

I have prepared and now present a table setting forth these figures.

MR. CARSON: Mr. Jones, I am going to ask the Commission if they will permit me to file that statement as an exhibit because it is in a form that cannot be conveniently copied into the record, if your lordship pleases. It will be Exhibit No. 273. The table is attached to the statement that is before the Commission but for the reason I have indicated I think it ought to be marked as an exhibit.

EXHIBIT NO. 273: Table re Class I roads, U.S., and Canadian Pacific, showing capital expenditures for replacements, additions and betterments, and funds available from depreciation retained from traffic revenues, retained earnings, and securities sold.

All right, Mr. Jones.

THE WITNESS: This table is annexed to my statement. From the table it will be noted that during the war years, 1941-1945, in the United States railway depreciation and amortization of railway defense projects which averaged approximately $541,000,000 were nearly sufficient to meet the cost of replacements, additions and betterments which averaged approximately $565,000,000. Retained

earnings and the proceeds from the sale of securities were used by the railroads to reduce debts and to build up their net current assets positions. Post war, the situation changed rapidly. Labour and materials became available for additions and betterments, but their cost was up and depreciation was sufficient for only 42% of the cost of replacements, additions and betterments on the United States roads in the years 1946 to 1948, inclusive, and in the case of the Canadian Pacific Railway depreciation, on the basis allowed by the Board of Transport Commissioners, provided only 48% of the relatively smaller capital expenditures of the Canadian Pacific Railway in the same years.

If I may interject there, I have since obtained some later figures and I find that in 1949 the cost of replacements, additions and betterments on the United States Class I railroads amounted to $1,295,000,000, and that in the year 1949 the depreciation amounted to $424,000,000. This means that if we average the four post war years in the United States, that is, the years 1946, 1947, 1948 and 1949, we find that the average depreciation amounted to $384,000,000, and the average amount spent for replacements and additions and betterments amounted to $992,000,000, so that in the four year period depreciation provided only 38% of the moneys which were spent for replacements, additions and betterments.

Similarly in the Canadian Pacific, depreciation, on the basis allowed by the Board of Transport Commissioners, in the year 1949 amounted to $18,000,000, and the cost of replacements, additions and betterments amounted to $56,000,000. So that the average amount for depreciation for the four post war years for the Canadian Pacific was $17,500,000 a year, and the average amount spent for

replacements, additions and betterments was $40,000,000 a year, and the percentage that depreciation. furnished of the cost of replacements, additions and betterments was 44%.

Q. That is the average for those four years?

A. That is the average for those four years.

Q. Yes?

A. The Canadian Pacific Railway had no railway earnings after dividends to retain and invest in the property in this period.

Q. That is referring to the period outlined in the statement?

A. In the four year period.

Q.It would apply to the four year period as well?

A. It would apply to the four year period as well. I do not have the figure on that basis for the year 1949 but I am informed by the accounting people that still remained true in 1949.

Q. Yes?

A. The Canadian Pacific Railway was fortunate, however, in being able to retain some of its "other income" for replacements, additions and betterments, but the high level of Canadian Pacific Railway's "other income", based as largely as it was upon the high price that Consolidated Smelters was receiving for its metals, is not continuing. Furthermore, it should not be counted upon as a source to provide the necessary funds for replacements, additions, and betterments to the railroad plant, nor should it be looked upon as a source to supply dividends that should be forthcoming from the investment in the railroad plant.

Therefore, the United States railroads and the Canadian Pacific Railway turned to the security markets, and, as shown in the table, Exhibit 273, sold the

following amounts of securities:

Q. The United States railroads referred to are Class I roads?

A. Yes.

	U.S. Railroads			C.P.R.
			(in millions of dollars)	
	Equipment Obligations	Other Obligations	Total	
1946	$ 143	$ 552	$ 695	$ 32
1947	$ 236	$ 26	$ 262	-
1948	$ 426	$ 176	$ 602	$ 37
1949	$ 434	$ 24	$ 458	-

During this four year period the securities sold by United States railroads other than the equipment trust obligations sold were almost entirely for refunding purposes except in the year 1948. In 1948 there were three important new money issues. The Chesapeake and Ohio Railway sold $40,000,000 of bonds; the Louisville and Nashville Railway $30,000,000 of bonds; and the Virginian Railway $9,500,000 of bonds to provide moneys for replacements, additions and betterments. The sales of securities by the Canadian Pacific were all equipment trust obligations. During the period Canadian Pacific paid back approximately $83,000,000 to investors in equipment trust and other obligations, so from their sales of $69,000,000 of securities they received no new money from investors but rather repaid them a net amount of approximately $14,000,000. In the four year period there were no sales to the investing public of either preference or ordinary shares by the Canadian Pacific or the United States railroads.

If I may digress from the text there I should like to comment upon Exhibit 264 which was introduced by Mr. Frawley into the record last Thursday. it consisted of a

letter from Mr. Boles, director of the bureau of finance of our Interstate Commerce Commission which stated that "only relatively small amounts of common stock have been sold by Class I roads for the purpose of providing new money." That exhibit, starting at the most recent item, shows a sale of $331,000 of stock of the Texas and Northern Railway in the year 1948. I have just stated there were no sales of stock to investors and I should like to point out this sale of $331,000 of stock was to a steel company which owned this railroad. In other words, it was not a sale in getting money from investors but was a merely a sale to the parent company of this railroad, the Lone Star Steel Company of Texas.

Similarly the sale mentioned here in 1946 of the Central Railroad Company of Pennsylvania of $750,000 of stock was a sale to the trustee in bankruptcy of the lessor of the Central Railroad Company of Pennsylvania.

(Page 20436 follows)

The Central Railroad of Pennsylvania is leased by the Central Railroad of New Jersey, and that railroad was in bankruptcy, and in order to keep this leased line in operation the trustee in bankruptcy bought this $750,000 in stock in the leased line.

Similarly, the two preceding sales mentioned here in 1940---

Q. You are still referring to Exhibit 264?

A. I am still referring to Exhibit 264.

Q. Yes?

A. Of the Chicago & Illinois Midland Railway Company two sales, one in 1940 and one in 1944, each amounting to $1,000,000, were sold to the parent company of the Chicago & Illinois Railway Company, namely, the Commonwealth Edison Company of Chicago. This railway is a subsidiary of the Commonwealth Edison, and the Commonwealth Edison bought these two blocks of stock of $1,000,000 each.

To go back to the 1930 sale of the Pennsylvania Railway Company, that sale was made in the amount of $7,379,000 as shown here, but I think in the record at page 20019 it is stated that the Pennsylvania sold $18,000,000. Actually of this $18,000,000 authorized only $7,379,000 was sold.

The Chesapeake & Ohio Railway Company was a successful sale of railway stock in the amount of the $38,221,000 shown here.

It is to be noted that of the $7,500,000 authorized by the New York Central, none of that was sold, whereas it is indicated on page 20019 of the record that that was sold. Actually it was authorized but not sold.

Q. Who is doing the talking there, please, at page 20019?

A. I think it is my friend Mr. Frawley from Alberta.

MR FRAWLEY: I am sorry, I did not catch what you said, Mr. Carson.

MR CARSON: I asked who was doing the talking at that page of the record.

MR FRAWLEY: I was introducing the exhibit.

THE WITNESS: That is right.

COMMISSIONER INNIS: Q. Coming back to the thirties, is there any indication as to the extent of Government support or Government provision of capital? That might be thought of as a fourth item which is not included in your document, of course, for reasons which are obvious, but what about the Reconstruction---

A. During the nineteen-thirties there were very large loans made to the railways by the Reconstruction Finance Corporation. I do not have the figures, and I hesitate to say what those amounts were, but they were in very large amounts.

Q. Have they been wiped out?

A. They have been handled differently. The Reconstruction Finance Corporation -- in the thirties, let me say, 30 per cent of our railroads went into bankruptcy or receivership, and the Reconstruction Finance Corporation was a holder of large amounts of securities in those bankrupt or receivership railroads. They then went in as a creditor in the reorganization proceedings and endeavoured with the other creditors to work out plans. Now, there have been some of those securities that were held by the R.F.C. that the railroads pulled through the thirties, and those were refinanced one way or another later on; some of them were paid down by railroads -- I mean, I do not want to give the figure, but the Texas & Pacific, for instance, had difficulty in getting money in the thirties; it needed only a few million dollars; it borrowed it from the R.F.C. and

repaid it. That was a successful operation of carrying that railroad through a period of stress. Now, there are other securities that were held by the R.F.C. that were bought by investment bankers and sold to the public; in other words, the public refinanced those. There were a number of equipment trusts which were purchased by the R.F.C.; I would say almost all of those were bought by bankers and resold to the public.

Q. Has there been any study made of that whole operation?

A. There have been a number -- thereare the annual reports of the Reconstruction Finance Corporation showing what have been their results. As a matter of fact, right nowthere is considerable agitation as to whether the R.F.C. should continue to be a lending organization of the United States Government.

THE CHAIRMAN: Q. When were they set up?

A. Let me see: I think it was under Herbert Hoover, in about 1931 or 1932.

Q. On account of the depression, was it?

A. That is correct, sir.

COMMISSIONER INNIS: Q. It is still in operation?

A. Well, its operations have dwindled greatly, and the question is whether it should be kept alive.

Q. It should not be included as a fourth item in your source of supply of capital?

A. That is a possible source of supply. That gets into a matter of public policy. Here in Canada I believe in the depression years there were certain loans made to both the Canadian Pacific and the Canadian National.

MR CARSON: Q. I think you had got to the bottom of page 13, Mr. Northey Jones, when you made your interjection.

A. We see therefore that for the Canadian Pacific all the money furnished by investors, and in the case of the United States railroads most of the new money furnished by investors, came from the sale of equipment trust obligations. Equipment trust obligations have been popular with investors because they are backed not only by the credit of the railroad but also by the equipment as security for the obligation. The use of these securities is favored by the railroads because money is obtained at low rates, but, as Mr. Unwin and I both testified in the Twenty Per Cent Freight Rate Case, the amount of money which may reasonably be raised by equipment trusts obligations is limited because, if a railroad keeps selling equipment trusts each year and there are equipment maturities each year, there is merely a revolving fund and no additional capital is being obtained from the investor, inasmuch as maturities get to be just as great as the borrowings and the railroad is not getting ahead with making additions. While undoubtedly railroads will continue to sell substantial amounts of equipment trust in the next several years, probably somewhat in excess of maturities, in my opinion, it is necessary to turn to other forms of financing if the railroads are to obtain the sums that should be spent on their modernisation. But, as a practical matter, will the investor buy other types of rail securities at reasonable prices, or at any price at all?

In my testimony in the Twenty Per Cent Freight Rate Case I discussed the decline in the past twenty years in the credit position of the railroads in the U.S. and of the Canadian Pacific as evidenced by the price of their securities in the United States and as reflected by the investment policies of U.S. life insurance companies, Canadian life insurance companies, and mutual savings banks

in the U.S. As of the end of 1949 only 5.0% or $2,959,000,000 of the $59,280,000,000 assets of the U.S. life insurance companies, was invested in railroad securities, whereas 16.2%, or $2,832,000,000 of $17,482,000,000 assets in 1929 had been so invested. Similarly only 3.6%, or $735,869,000 of the $20,471,000,000 assets of the mutual savings banks was invested in rail securities at the end of 1948 compared with 14.0%, or $1,540,038,000 of the $11,018,317,000 assets in 1931.

In other words, there was an actual decline in the holdings of rail securities by the savings banks, and a great decline in the percentage of assets invested in railroad securities, and in the case of the life insurance companies a very small increase in the actual amount of holdings, and a large decline in the percentage of assets invested in railroads.

For Canadian life insurance companies much the same situation exists. The report of the Superintendent of Insurance of Canada indicates that at the end of 1947 total admitted assets of these life insurance companies were $3,919,100,000, of which only $19,149,000, or .49% of the assets, were invested in railroad securities, whereas in 1929, of total admitted assets of $1,414,784,000, $15,434,000, or 1.09% of the assets, were so invested. In short, right here in Canada your life insurance companies, which are a big source of capital for investment in enterprises, are not putting their money today into railroad securities.

The relative decline in credit standing of the railroads and in investor interest in railroad securities is also shown by the figures of the Dow-Jones stock averages for the period from 1921 to date. The Dow-Jones average price of railroad stocks at the end of 1921 was 74 and a

fraction, and of industrial stocks at the end of 1921 was 81 and a fraction, or in other words, based on the Dow-Jones indexes rail stocks were selling at prices about 90% of the prices for industrial stocks. Both the railroad and industrial averages went up in the late 20's and then declined during the 30's. Now the railroad security index is at 55 and a fraction compared with the industrial average at 214 and a fraction, or, in other words, rail stocks have declined to a point where they are selling on an average at only a little more than one-quarter of the average of industrial stocks.

In my testimony I endeavoured to show what, in my opinion, were the causes of this decline in railroad credit and some of the steps which should be taken to re-establish a better credit position for the railroads and to restore investor confidence in them. Basically, what is necessary is that earning power should be restored and the belief that earning power is not and will not be in jeopardy. Earning power is dependent uppn physical volume of business, rates, expenses and charges. At present there seems to be some hope that the volume of business in the 50's, in both the U.S. and Canada, despite competing carriers, may exceed all decades except the 40's, and in Canada, due to the relatively steady growth in economic activity and less truck competition, may well exceed the 40's. Both the U.S. and Canada have had rate increases, but in Canada such increases have been substantially less than in the U.S.

At this point let me reiterate that if the people of Canada are to have a strong, healthy and dynamic C.P.R. the earnings of the C.P.R. must be such that not only the operating costs of business are covered - but also the costs or wages of capital must be covered. Furthermore the return

to the investor should be sufficient to assure confidence in the financial integrity of the enterprise as as to maintain its credit and attract capital for necessary additions and improvements. The C.P.R. must compete in the capital markets to attract its capital, and investors will put their savings in C.P.R. securities only if the wages to C.P.R. capital are commensurate with wages paid to capital in other enterprises.

How then do the specific proposals of the C.N.R. for recapitalization directly impinge on the credit position of the C.P.R., on its ability to finance needed additions and betterments, and on its ability to furnish modern and efficient transportation, and do these proposals of the C.N.R. imperil the C.P.R. and as such do they constitute serious threats to shippers, taxpayers, investors, and all people of Canada?

If the Canadian Pacific is to have sound credit, the competitive position of the Canadian National and the Canadian Pacific must be fair in the matter of passenger and freight rates. In the submission of the Canadian National it was stated, as to the men and women who work for the Canadian National, that "they know their railway is the largest in Canada, the only one with lines in every Province, and they cannot understand why another railway, inferior in size, should become the standard in rate matters." On the other hand, Mr. O'Donnell (page 18828 and subsequently) said, on behalf of the Canadian National, "that in so far as this Commission is concerned there has been no request put forward by the Canadian National Railways to be made the yardstick." The Board of Transport Commissioners in the 20% Freight Rate Case said: "It may well be that the time has gone by when a consideration of the financial requirements of the Canadian Pacific Railway,

either determined by a study of that company's financial operations or determined by the application of an appropriate percentage to its rate base should be the yardstick for all the other railways in Canada, without giving more detailed study to the financial needs of those railways or an appropriate rate base for each of them. It may very well be that the proper basis for establishing freight rates in this country should follow a revision of the capital structure of the Canadian National Railways and the appropriate statutory direction to this Board as to freight rates based on that valuation."

MR CARSON: That quotation comes from page 11 of the printed pamphlet of the judgment dated September 20, 1949.

THE CHAIRMAN: The 21% judgment?

THE WITNESS: The 20% Case.

MR CARSON: In the 20% Case; it was what we call the 8% judgment.

THE CHAIRMAN: What is the date of it?

MR CARSON: September 20, 1949.

(Page 20446 follows)

THE WITNESS:

It would seem, therefore, that there is at least the possibility that in some respects the Canadian National may become the yardstick in rate matters - indeed, there is a serious question whether the Canadian Pacific could remain the standard if the Canadian National were granted the relief it has requested and is not required to use earnings over and above its reduced fixed charges to pay a return on its equity capital.

If the Canadian Pacific is to remain the standard in rate matters, and rates are set so that the Canadian Pacific could earn after income tax an amount somewhere between the $47,500,000 requirement set forth in the February 28, 1950 judgment of the Board of Transport Commissioners, or a return of 4 3/4% on the approximate billion dollars of capital invested in the railway enterprise, and the $66,600,000, a return of 6 2/3%, which in the Twenty Per Cent Freight Rate Case I testified was in my opinion the minimum wage necessary to attract new equity capital to the enterprise, it seems reasonable to suppose that the Canadian National with its larger system and greater gross revenues, should earn at least $50,000,000 a year before income tax.

If I may interject something there, I should like to do so. For instance, if there was to be a straight across-the-board increase in rates of 5% for the Canadian National and the Canadian Pacific - -

MR. CARSON: Q. You are taking that rate as an illustration?

A. Yes, as an illustration; 5% on the $500 million of gross revenues of the Canadian National is $25 million; and 5% on the $360 million of the Canadian Pacific is $18 million. On any earnings that the Canadian Pacific

makes over and above its fixed charges, it pays 35% tax. So that we see that if there was this type of straight across-the-board increase in rates whereas the Canadian National, with such a hypothetical increase as 5% would get $25 million the Canadian Pacific would get $18 million less approximately 1/3 or $6 million, or $12 million. So that for each dollar that Canadian Pacific obtains the Canadian National would receive about $2 a ratio of about $ 25 million to $12 milliion.

MR. O'DONNELL: Q. You are speaking in gross figures?

A. That is right.

MR. CARSON: Q. That is to say, you take the $18 million to the Canadian Pacific and as you pointed out, about a third of that would be required for income tax purposes?

A. Yes.

Q. Which would leave about $12 million for the Canadian Pacific compared with $25 million for the Canadian National?

A. That is so. To continue:-

If the Canadian National were to be recapitalized as proposed, earnings of $50 million a year would leave, after allowing for approximately $15,000,000 of net charges on the railroad's net debt of $284,000,000, $35,000,000 per year surplus earnings. Even if the Canadian Pacific were still the yardstick for rate matters it is hard to beliewe that if such a sum were to accrue each year to the Canadian National, there would not be a strong demand form many people for lower rates, or even a demand that the Canadian Pacific no longer remain the yardstick.

The net railway operating revenue of the Canadian National amounted to more than $50,000,000 in each of the years 1941 to 1945 inclusive. Suppose the Canadian National were to be the yardstick in rate matters, what would the result be if it were to have net railway operating revenues of $75,000,000? Based on past results, gross revenue of approximately half a billion dollars in 1949, and Canada's expanding economy, such a sum is certainly not unthinkable. Under the recapitalization plan there would be surplus earnings of approximately $60,000,000 a year after the $15,000,000 of net charges on the railroad's net debt.

With such a sum, and the Canadian National then as the yardstick, there would certainly be strong agitation for lower rates by such interests as advocate rate reduction. If rates were reduced as a result of such agitation, the taxpayers of Canada would be deprived of the relief to which they are entitled by way of a return on the amount they have invested in the Canadian National and the position of the Canadian Pacific would be gravely imperilled.

On the other hand, if earnings in the future are at a low level the Canadian Pacific may be forced to request increases in rates. In such a case the Canadian National, if it is covering its net charges of $15,000,000, with no additional sums required to be paid out as a wage on capital invested in the enterprise, it may not go along with the Canadian Pacific in its request for increased rates.

If I may, I should like to interject here that in fact it seems hard to think they would if the ability of the Canadian National is as it was expressed by Mr. Fairweather at page 20337 of the record when he said,

"We are content if we can operate without deficits," and he was speaking there of operating without deficits after $15 million or $17 million of fixed charges.

MR. O'DONNELL: That is rather taking it out of its context , is it not, Mr. Jones?

THE CHAIRMAN: What is that?

MR. O'DONNELL: I suggest, my lord, that that is rather taking the statement out of its context.

MR. CARSON: Perhaps my learned friend could put the context to him in cross-examination.

MR. O'DONNELL: All right.

THE WITNESS: To continue:

The likelihood that the Canadian Pacific could then secure increases adequate to meet its requirements would be lessened. If the Canadian National did join in the request for an increase in rates, and rates were lifted so that the Canadian Pacific could earn an adequate wage on its capital, the Canadian National might then start accruing relatively large surpluses and there would again be pressure for reduced rates. In any of the foregoing cases, first the credit position of the Canadian Pacific would be endangered, then its ability to perform an efficient transportation service would be impaired, and eventually the possibility that it might have to be taken over by the 'Government and supported by the taxpayer would arise.

In my opinion, the most dangerous feature of the Canadian National's proposal from the standpoint of the Canadian Pacific is the absence of any requirement that earnings in excess of the very low fixed charges of $15,000,000 to be paid out as a wage on the taxpayers'

investment in the Canadian National enterprise. If the Canadian National's proposals were adopted, it is my firm opinion that whether Canadian Pacific or Canadian National or both become the yardstick in rate matters, the Canadian National's earnings after the reduced fixed charges would have a material effect in the fixing of the rate level. If the wage required to be paid on Canadian National capital is reduced to approximately $15,000,000, which is only some 3% of its gross revenues and only about 1% of the capital invested in the enterprise, my firm opinion is that the Canadian Pacific would be put in a disastrous position and great disservice would result to the people of Canada.

MR. CARSON: Thank you, Mr. Jones.

THE CHAIRMAN: Does anyone wish to ask any questions?

MR. COVERT: Yes.

EXAMINATION BY MR. COVERT:-

Q. Mr. Northey Jones, would you refer to page 2 of your statement?

A. Yes.

Q. In the last paragraph, about the third or fourth line from the bottom of the page you state:-

> "In connection with the registration statements filed by the Government of Canada with our Securities and Exchange Commission I had to make a study of the figures of the Canadian National Railway for inclusion in such registration statements."

When would that be?

A. The most recent of those registration statements were filed in August of 1949.

Q. Yes?

A. The other ones were filed in 1937, in 1938 and in 1943. There were $85 million of bonds under-written in 1937 by a group managed by our firm; $40 million in 1938; $90 million in 1943 and $100 million last summer, in August.

Q. What I really wanted to find out was how extensively you would examine the figures of the Canadian National, and whether or not that examination would give you a pretty fair picture of their financial position?

A. It was done because in selling securities to the United States public, our securities act says the whole truth in effect must be given - it is the truth and securities act - and that the people shall not be given any misleading statements nor shall there be any omissions which would make the statements that are made misleading.

Q. Yes?

A. In that connection, an important asset of Canada is the Canadian National Railway. At one period in 1943 when they were earning money, that showed up as in the revenues of Canada; that showed in the statement of revenues and expenses of Canada that the Canadian National was not a burden. In the recent statement filed last summer, it showed that the Canadian National was a burden. Furthermore, in the statement of the active assets of the Government of Canada are included the loans which are made to the Canadian National, and those loans are deducted

from the gross debt of Canada, and the figure of the Canadian National debt is reduced by the amount of the bonds of the Canadian National which is held by the Government. Therefore, with such a stake in the railway, in describing the Canadian Government finance you must show, as far as their debt position is concerned, that they are considering as an asset and an active asset as an offset to part of their debt, the debt which is owed to them by the Canadian National.

Furthermore, in discussing the revenues and expenses of the Canadian Government, you must show whether they are currently a drain or whether currently they are turning something into the treasury of the Canadian Government.

Q. In considering the Canadian bonds, I suppose they would show the bonds of the Canadian National Railway which were guaranteed by the Dominion, would they?

A. That is correct.

Q. At any of these times when you were considering these matters, had you formed any opinion as to the capitalization of the Canadian National, or did that phase of the matter bother you at all?

A. I would say that that phase never came up at that time. In going over with the Government officials the active assets of the Government, we discussed with them as to whether they were really active assets. But whether they should be recapitalized or written down -- there have been certain active assets of the Government that have been written-off at times -- there was no consideration. Well, maybe I should not say that. I mean, there was a discussion about the capital. In 1938,

we discussed the capital revision of 1937.

Q. When considering the sale of these Government of Canada bonds at any of these times, had you drawn any conclusions as to the earning power of the Canadian National? Did that consideration enter into the picture?

THE CHAIRMAN: Would you repeat that question, please, Mr. Covert?

MR. COVERT: I asked him, Mr. Chairman, if at any of the times he was dealing with the sale of these Government of Canada bonds, he had arrived at any conclusions as to the earning power of the Canadian National or whether that was a serious item in connection with the sale of the bonds.

THE WITNESS: I would say that in the 30's the position of the farmer in the west and the railroad deficit both were considerations which investors were looking at.

MR. COVERT: Q. Yes?

A. And that when we come to 1943, in the wartime economy, both those were lifted and we also had a different type of money market which was more of a managed money market both in the United States and in Canada; that that situation had cleared up at that time. Last summer they had a situation that the Canadian National was showing bad results; but I would say that we were hopeful that if there might be a better balance between rates and wages paid, that situation would improve.

Q. You said the issue in 1949 was $100 million?

A. That is correct. In that respect I might point out that the issue was to procure United States dollars. The United States dollars were then sold to the Canadian

Railway, and the Canadian National Railway was enabled to call, last October 1, $57 million of 5% bonds with the United States dollars they had so bought from the Canadian Government. Furthermore, it was to take care of further United States dollars to call an issue of $17 million of bonds of the Canadian National on February 1 of this year. Then the Canadian National, to get the Canadian dollars with which to buy the United States dollars from the Canadian Government, sold an issue of 2 7/8% bonds here in Canada last fall and by so doing took a good forward step in reducing their fixed charges by reducing the rate of interest that they were paying from 5% to 2 7/8%, with a consequent saving I think on the 1949 operation, although I am not just sure...I think in the 1949 Annual Report of the Canadian National Railway they report that the transaction in refinancing last year involved a saving of $1,326,000, I think it is. I am sorry, I see that the report says: "This refunding operation effected an annual saving of $1,382,548.

Q. You are reading from the Canadian National report?

A. From the Canadian National Annual Report, page 9.

Q. That is for 1949?

A. 1949.

(Page 20460 follows)

MR. O'DONNELL: You might read the whole thing. It gives the detail at that point.

THE WITNESS: I will be glad to. I do not mean to take things out of their context, Mr. O'Donnell.

MR. O'DONNELL: No, I know that.

THE WITNESS:

"Finance. Two bond issues were made during the year. On January 3 there was an issue of $35,000,000, 3%, 17-year bonds. These were sold at a cost to the Company of 3.075%. On September 15 there was an issue of $70,000,000, 2-7/8%, 20-year bonds, the cost to the Company being 2.96%. The proceeds were used mainly to finance capital expenditures and to redeem $57,728,500 of 5% bonds due October 1, 1969, called for redemption October 1, 1949. This refunding operation effected an annual saving of $1,382,548."

MR. COVERT: Q.Now, Mr. Northey Jones, as I say the total issue in 1949 was $100,000,000?

A. That is correct.

Q. And I suppose it would be fair to say that regardless of what the earning position of the Canadian National was at that time you would still have undertaken the sale of $100,000,000 of government of Canada bonds?

A. We would be very happy to.

Q. What I was really trying to find out was whether or not at any of these periods you had really made a particular study of the Canadian National with respect to either its capitalization or the value of its property?

A. I would not say a particular study the same way that we would make if we wer selling securities for the Canadian National itself. I mean after all while the Canadian National is very important to Canada, Canada's

people and to government finance it is still one element whereas if you are selling securities of a railroad itself you have to make a more detailed study of the railroad itself.

Q. Could you tell me the interest rate on the $17 million that you referred to?

A. I believe that is 5%. Did I make an error in that?

MR. O'DONNELL: That is right. It is not in that report because it is this year.

THE WITNESS: I am reading from page 29 of the 1949 annual report of the Canadian National Railways and it shows that it had an issue outstanding on December 31, 1949, of 5% 40-year guaranteed gold bonds of the Canadian National issued February 1, 1930, due February 1, 1970, outstanding in the principal amount of $17,338,000 on which $866,900 of interest accrued in the year 1949. These 5% bonds were called for payment on February 1, 1950.

MR. COVERT: Q. Now, at the bottom of page 5 of your statement you say:

> "It would seem to me to be exceedingly difficult to establish a proper capital structure for the Canadian National based to a large extent on its earning power if in turn the Board which establishes the rates determining earning power is waiting to see what the revised capital structure will be."

Now, I wanted to find out if you had made sufficient study to say how you think a proper capital structure of the Canadian National should be based ?

A. Well, both myself and my partners of course are put to the problem of raising money for enterprises of various kinds, railroads, public utilities, industrial companies.

We have to compete in a market with other securities, and investors will only buy a given security if the wage of the capital which they invest in that is commensurate with the wages paid for other types of capital considering the risks involved.

Q. That is a new name for dividends.

A. For instance, one of my partners testified in New York state recently in the New York telephone rate case. In public utilities in the United States the general theory is that it is a fair rate of return on a fair rate base. We believe in that, if that is an answer to your question.

Q. Yes.

A. But there is a further thing. You get into the tests of what is a fair base and what is a fair rate. You get into more questions. As I testified in February a year ago up here I said that if the Canadian Pacific is to be a progressive, dynamic railway it must be able to attract capital to make these improvements, and if it is to be able to get capital it must pay a wage on that capital that will attract investment.

Q. I intended to take that up with you a little later because I think you dealt with that later in your statement, but I what I wanted to ask was if you had given any particular thought to the Canadian National because you say here that:

> "It would seem to me to be exceedingly difficult to establish a proper capital structure for the Canadian National"--

THE CHAIRMAN: What page is that?

THE WITNESS: The bottom of page 5.

MR. COVERT: And the top of page 6.

"-- based to a large extent on its earning power if in turn. the Board which establishes the rates determining earning power is waiting to see what the revised capital structure will be."

Q. It may be you simply mean that since one is depending on the other that creates a difficulty?

A. That creates a circle.

Q. What I want to find out is if you have any ideas or suggestions you can make to this Commission as to what is a proper method of determining the capital structure of the Canadian National, whether it should be based on earning power or just what you suggest?

A. Well, I think it would be rather presumptuous for somebody from the United States to say what he thought the Canadian government and the people of Canada should say was a fair return on the dollars which they have invested in this great national enterprise. I do think though from the point of view of the Canadian Pacific, that if they are not allowed what is fair in all the circumstances to the taxpayer of Canada and to the government of Canada, that then we have an impossible competitive position with the Canadian Pacific, because if their requirements or their rate of return is going to be set so low in the consideration of rate matters then the Canadian Pacific will have such a low state of earning that it will not be able at all to get any more capital but will deteriorate and eventually become bankrupt.

COMMISSIONER ANGUS: Q. Mr. Northey Jones, on the evidence you are presenting to us you have in mind a proper rate of return for the Canadian Pacific?

A. That is right.

Q. Wouldn't the rate of return for the Canadian National be derivative from that? If the Canadian Pacific

is earning so much then approximately one could calculate what the Canadian National would be earning?

A. I would think so, that taking, as I said, a 6-2/3% return that I thought was necessary to attract new equity capital to the Canadian Pacific, a figure such as that on the rate base of the Canadian National, and whether you adjusted that rate base to take care of what we call in the United States deficit mileage or whether you adjust the rate of return downwards from the 6-2/3 is a matter which your commissions up here would decide, I presume. I believe that question was asked Mr. Cooper back in the cross-examination, and I think he said he would rather have the rate base adjusted.

MR. O'DONNELL: Q. He said leave it to the Board, too, didn't he?

A. Well, I am sorry if I misquote him but that was just a recollection.

MR. EVANS: I think the recollection is quite right.

THE CHAIRMAN: What is your interjection?

MR. O'DONNELL: I said Mr. Cooper, as I understood it, said he would be prepared to leave that matter to the Board of Transport Commissioners. He had views but he was prepared to leave it where it belonged.

MR. COVERT: I think they are both right, Mr. Chairman.

Q. What I really wanted to find out here was this, whether you suggest that there is any other way to establish a proper capital structure other than based on the earning power of the road, whether it can be determined, for example, by a comparison of the funded debt and its gross earnings, or whether you can compare it with other Class

I roads and arrive at a fair figure as to what their capital structure should be?

A. Well, there are all kinds of maybe you might say rule of thumb tests that are talked about. When I first went into the bank in 1919 someone told me that you should never borrow more than you have; in other words, your fixed interest bearing debt percentage should never be over 50%. I would much prefer to see a capital structure with less than 50% of debt. For long years the savings bank rule in the New York Savings bank was that to be legal for investment in/the by savings bank a corporate debt, railroad debt, should not be more than 60%. The real estate mortgage provision in New York for legality for savings bank investment was 66-2/3% debt. In these new pipe line proposals, and pipe lines which are being constructed in the United States the debt goes up much more than 60%, and part of that is a peculiar matter which arises out of the fact that interest during construction can be charged to capital cost. As a result they borrow more than, in my opinion, they should.

Q. Isn't that --

A. On the other hand, we come to the American Telephone Company which is on the other side of the picture and Mr. Lee Wilson, the president, at the annual meeting last week said he was very much disappointed, maybe we should say, that increasing his capital from $4 billion at the end of 1945 to $7-¼ billion at the end of 1949 -- he did not say these words. I am coming to what he said. These are what the facts are -- that in raising this $3¼ billion in four years or over $800 milli n a year he did a great part of it by debt securities, and his debt increased from 31% of his capital structure in 1945 to approximately 50% at the end of 1948 and 1949, and he said his goal was to get

it back to 33% of debt.

Then again another factor which comes into financing is the cost of raising money. That has led in the United States to people increasing their debt rather than raising equity capital.

Q. Well, coming back to my question, Mr. Northey Jones, would you say that there are any simple rules as to the basis that the funded debt should bear to the equity capital, and if so would they apply, in your opinion, with equal force to both the Canadian Pacific and the Canadian National?

A. I don't know whether I could express that as a rule. I would say that in the firm of which I am a member -- and we digress from this principle -- our principle is that in talking to companies about raising money, and it varies with the type of industry that you have, that the debt should not be more than 50% and should approach one-third.

THE CHAIRMAN: Q. 50% of what?

A. Of the capital structure; in other words, that there should be 50% in equity and 50% in debt, and that in a commerial enterprise it is much better to strive for the 33% in debt and two-thirds in equity because if you have an impact at any time, like the telephone company had following the war where it was necessary to raise such vast amounts of capital, then they have room to expand that up to the 50% without getting into serious trouble, and they can do it at not too expensive a rate. Now that this terrific capital expansion which they underwent in the past four years is slowing up they can start to get back towards the 33%, but you asked me, Mr. Covert, whether that would apply equally to a commercial enterprise and to the Canadian National.

Q. Let us assume they are both commercial enterprises.

I said the Canadian Pacific and the Canadian National.

A. Well, I think it is hard to assume that they are both commercial enterprises. In my testimony a year ago I said that I thought the Canadian Pacific should strive to get its debt down from the figure where it is now, between 45 and 50% of its capital, down to a figure nearer 33-1/3% because that would improve the position of the equity holder and would enable them to get equity capital more quickly.

In the case of the Canadian National the situation is different in that the capital does not have to come from the investing public. They get their capital from the government. That is a little different, and there has not been any requirement made that there be any payment made to the government on some $700 million of equity capital now owned by the government.

THE CHAIRMAN: We will take a few minutes' recess.

-- Recess.

(Page 20472 follows)

...UPON RESUMING

MR. COVERT: Q. Am I correct, sir, that you suggested that it costs more to raise capital now than it has in the immediate past?

A. Well, if you say now in 1950, I don't say, "No, sir". It all depends upon the type of capital you are talking about, but generally speaking, bond prices are very high relatively and the cost of borrowing money is less than it has been for several years. There was a peak in the bond market and a low point in the cost of debt money in 1946. Then from that peak bond prices went down and they have been rising for a period. For instance, based on bond yields in the United States - the railroad bond yields, and when I speak of yields, that is the percent you get by investing in railroad bonds. For instance, in 1946 they reached a low point of 2.91 percent; in 1947 the bond prices declined and the yield, therefore, was greater to the investor in buying them, 3.11 percent. In 1948 it was 3.34 percent; in 1949 there was an improvement and it went to 3.24 percent. and on March 30, 1950, based on this index of Moody's, which is one of our large statistical organizations, it was 3.08 percent. Now, the same trend was noticeable in public utility bonds, and industrial bonds, but their cost was lower than for raising railroad capital. And actually while those are the yields on a large number, they are based for overall on, all corporate bonds in the United States the low yield figure in 1946 was 2.74 percent. It went to 3.08 percent in 1948 and on March 30, 1950, was 2.84 percent. That is based on existing outstanding 120 bonds. When it comes to raising new money,

the railroads would not be able, for instance, today, to raise new money at 3.08 percent on the average, although that is what the average on these 120 -- not the 120, because there are not that many rails in it, but the number of rails that are in it, would yield. There have been in the United States two important issues of securities since the beginning of the year; one for refunding purposes by the Chicago, Rock Island and Pacific when they sold some bonds to refinance and get a reduction in interest, and those bonds were offered to the public on a 2.90 basis for a thirty year bond. Then the Chicago, Burlington and Quincy Railroad sold $25 million of bonds on March 28th of this year, where we sold $25 million of bonds for the Burlington at a price of 100, a 3% bond or a 3% rate. Similarly here in Canada since, recently within a month, the Canadian Pacific has been able to sell some 3 1/8% twenty year bonds at a slight decline from par, so that the yield to the public was about 3.20%.

Q. They were thirty year bonds too?

A. Twenty year bonds, and they had a speculative feature -- I hope it is a good speculative feature -- in that they are convertible bonds, and I hope some day that the stock would be worth such a price that they will be able to convert them.

COMMISSIONER INNIS: Q. When you said in answer to a question by Mr. Covert that the costs of floating capital were higher, that is not quite accurate?

A. No, I want to point out that when I said the costs of floating debt capital have improved, I mean, you had a peak in 1946 when you had the cheapest time of financing, then they declined, prices declined, and your cost of financing

then went up. Here at the beginning of 1950 it is the best it has been for a couple of years as far as debt is concerned. On the other hand, it is not exactly fair, probably, to take these examples that I have taken of the Chicago, Rock Island and Pacific on a 2.90% basis; the Burlington, it issued $25 million on a 3% basis of which incidentally, half was new money to build a cut-off which is going to cut their distance from Chicago to Kansas City and so improve their running time and efficiency and lower their costs, or this issue of the Canadian Pacific, because while these three railroads were able to do that, very few railroads of the United States are able to borrow money on these terms. In other words, those are good railroads.

COMMISSIONER INNIS: Q. What would be the more general run?

A. This goes back to last summer, but we had a refunding operation to do for the Western Maryland Railroad and in connection with that they were going to decrease their debt, that is they were going to redeem about $9 million worth of their debt and they only wanted to take $7 million out of the treasury, and they asked us to raise $2 million so they might redeem this debt to improve the mortgage position of the new security that we were arranging for them. I went all over New York and New England trying to sell those $2 million of bonds for the railroad, for the Western Maryland Railroad. I finally got the Northwestern Mutual out in Milwaukee and the New England Mutual in Boston each to take a million of these bonds.

THE CHAIRMAN: Q. They are insurance companies?

A. Yes, my lord. These were twenty year 4% bonds. The Atlantic Coast Line, as I mentioned before, we were

doing some work for them and we were trying ahead of maturity to take care of $50 million bond issue which matures in 1952, from the Coast Line. In order to attract those people to exchange the two year bond for a thirty year bond the Atlantic Coast Line is offering to raise the rate of interest for two and a half years until the old bonds matured, from 4% to 4½% and pay 4% thereafter for the 30 years. You are up in the neighborhobd of 4%. The Seaboard Railroad will shortly call for a new issue of bonds and that is a bidding matter, but their rate will be down toward the 3 rather than jp towards the 4, but there is that gamut between the 3 and 4%

MR. O'DONNELL: Q. The C.P.R. bonds are 3 1/8%.

A. Yes, with a slight discount.

MR. O'DONNELL: A price of 75 and accrued interest.

MR. COVERT: Q. Again on page 5 of your statement in the first part of the latter paragraph, you say:

> "In this connection, I note that in the December 31, 1949 balance sheet of the Canadian National Railways no depreciation is provided against road accounts, which would seem to indicate that there is room for recapitalization through the provision of such depreciation reserves."

Would you first explain what is meant there and secondly, how much of a recapitalization there would be, if you have given any thought to that?

THE CHAIRMAN: You mean the road account?

MR. COVERT: No, my lord. He says there that the fact that there is no depreciation provided as against the road accounts - -

THE CHAIRMAN: That means the road property?

MR. COVERT: Yes, my lord. My understanding sir, is that the Canadian National Railway has depreciation for equipment, and so on, but on the ---

THE CHAIRMAN: Q. Let us see what Mr. Northey Jones has to say about road accounts?

A. I have in mind accounts which we classify in the United States, the property account of the railroads is under two headings, 1 - Road, 2 - Equipment. Road accounts include grading, ballasting, ties, railroads, stations, bridges, signals, engineering, all that have to do -now, there are two parts to that. There is one known as track accounts which have to do with the rails and ties and the ballast and the tie-plates. The depreciation on those is taken care of, that is, the physical wear and tear is taken care of by maintenance. On bridges and structures, stations and similar items in the United States we have depreciation. We find that those things wear out or become obsolete and they have to be replaced. There was one time where a number of railroads found they were not getting out of their traffic revenues the money to replace those items, and they came in bunches and, I think they were happy when the I.C.C. set up a depreciation on those accounts. I think proportion of depreciation in the United States which goes to the road accounts as compared with the ones that go to the equipment accounts has been rising somewhat. Now, when I say there is no depreciation there - -

THE CHAIRMAN: Q. Can you give us any figures of proportions?

A. I will find that, my lord. Shall we go on with this? I am sorry, I am not trying to get away from your question, sir.

MR. COVERT: Q. You say there is room for recapitalization through the provision of such depreciation reserves, and that is what I wanted an explanation of. How would that be done?

A. I would say, sir, and that maybe enters into what Dr. Angus mentioned, that I presume that in your capitalization you would have the capital liabilities in the form of debt and equity capital on one side and on the other side you have the investment in property and if the net investment in property is reduced because there is depreciation in some of those items that would reduce the asset side. I note here in Canada you carry your reserves on the liability side, but I mean that is purely a matter of accounting, whether you carry them over there or carry them on the asset side as a deduction from the asset. But, if through a write-down of the net property account either through the provision of depreciation reserves or because some of the loss in this mileage, maybe, should be recognized and it should be re-valued on the basis of what the situation would be to-day. If, thereupon, you get a lower net asset position on the asset side, you correspondingly have got to reduce your capital on the liability side, and that, in effect, is what in a number of the re-organized railroads in the United States they have in effect decided, that the property value that was on the asset side does not really exist in the terms that it was set on the books of the company before and either by providing what we call down there an acquisition account sometimes these asset values are reduced and the capital structure is correspondingly reduced.

Q. As I take it, you are suggesting that you would write down the assets by the amount of depreciation which, you say, would be applied to the road accounts?

A. That is right.

Q. And then reduce the capital on the liability side accordingly?

A. Yes.

Q. What I want to find out is that when you say there is room for recapitalization, through the provision of such depreciation reserves are you suggesting that since you have noted this in 1949 tyou are assuming that situation has existed in the past?

A. Yes, there is an accumulated reserve.

Q. Therefore you would find out what that accumulated reserve should be, and adjust the capital on the liability side accordingly?

A. That is correct, sir.

Q. If they have been taking care of that depreciation on the basis of renewal or retirement accounting, could you still do what you suggest?

A. If -- and I say if -- there is no depreciation in the structures on the Canadian National that has not been taken care of by maintenance or renewal accounting, I would be very much surprised. If there is none and if there is no depreciation there it would be the first company that I have ever seen where there was none. That is not in my province to say, and I would rather not get into a discussion as to the relative merits of various forms of taking care of wear-and-tear and obsolescence on property, but I would think there is and you get all the way from straight line and you get to the position which is obtained sometimes in the courts in the United States where they say you should only provide for what is known as observed depreciation.

(Page 20483 follows)

Q. Let us not get into that, then. Let me pursue this this way, Mr. Jones: Supposing---

A. I am not trying to get away from your question.

Q. No. no. What I want to find out is this: Let us assume that you could recapitalize, as you say, through the provision of such depreciation reserves. Now, let us say that that meant writing down on the asset side the road property account?

A. Right.

Q. Now, on the other side, what would your proposal be? You would write down the capital by the same amount; you would write down the capital on the liability side by the same amount?

A. Yes.

Q. And would you do that by a reduction of the funded debt?

A. Well, I think you get back into the question you asked me before. If you reduce the total assets and you reduce the total liabilities, and let us assume just for a minute the 50 per cent ratio, if it is going to be a 50 per cent ratio after reduction, that may mean that the debt is cut down.

Q. In other words, you would reduce the capital on the liability side so that there would be about 50 per cent of equity capital and 50 per cent of funded debt?

A. I am saying that is one theory on which it might be done, yes, sir.

Q. What I wanted to find out, you see, is, when you say having observed this, there is room I just wanted to find out how you were going to go about it?

A. These matters -- and I am not trying to be evasive -- all these matters, each one has to be studied on its own merits, and if in a railroad you find that there

is room for a restatement of your assets, then there has got to be a corresponding restatement of your liabilities, and in that -- well, I do not like to make absurd hypotheses, but on the other hand maybe the best illustration is to take it. Now, we have $2 billion, roughly, of assets of the Canadian National. I hope you won't hold me to the exact figures.

Q. Oh, no.

A. And we have $1.3 billion of debt and $700 million of equity. Now, to be absurd, let us say that the assets are only $1 billion, and then the liabilities should only be $1 billion, and then if you take a 50 per cent ratio -- and I do not say that that in this case is necessarily the right ratio, although it is a ratio which is a fundamental, maybe I might say, credit rule, that a man ought not to borrow more money than he has -- then you would have half a billion of debt and half a billion of equity capital. That figure, which I say I think is absurd, would result in a reduction in your debt from $1.3 billion to half a billion if you were going to follow the 50 per cent rule, and would result in a reduction of the equity from $700 to $500 million. Now, I do not think those are the right figures; don't let anyone have that impression; it is just to illustrate what happens, and I am trying to answer your question as directly as I can, sir.

Q. Now, my next point on that is, supposing it were done that way, what I cannot quite follow is why that would make any difference to the Canadian Pacific, whether the Canadian National's capital was revised in this manner or by the manner they suggest?

A. Well, maybe I have gone too far afield in even suggesting that there was room for a revaluation or a restatement of the assets. I would think that it gets more

to the question, if there is going to be a fair comparison in rate matters, and if -- and I say if -- a rate base were determined, and if, as it might well happen, a rate base would be established for both the Canadian Pacific and the Canadian National, that rate base then would be influenced by a consideration of a matter such as this possibility let me say of accrued depreciation on the road accounts of the Canadian Pacific.

Q. Then, Mr. Northey Jones, can I put it this way, that as far as this statement about room for recapitalization through the provision of depreciation reserves is concerned, whether it is done that way or in another way, that does not go to the root of the problem as far as your brief is concerned?

A. I would say that it did not, no, sir.

Q. Then the next thing I wanted to discuss with you is at page---

COMMISSIONER ANGUS: Q. Mr. Northey Jones, is what you call the 50 per cent rule based on the assumption that a return is being earned on the equity capital?

A. That is so, sir, and I hope in the last part of my answer to one of Mr. Covert's questions that I pointed out that the situation was different between a privately-owned enterprise and a Government-owned enterprise, in that in the privately-owned enterprise that capital, that equity capital, must be secured from the investing public, whereas in the Government-owned the equity capital is furnished by the Government; and, as I said before to you, Dr. Angus, the amount of that return to the taxpayer in Canada, the Canadian Government and the Canadian National and your commissions up here should determine, but it seems to me that if you are going to have fairness in rate matters the Canadian Pacific has got to earn a return on that equity

capital to live, therefore if it is going to be fair there must be some fair determination of what the equity capital in the Canadian National shall earn and pay.

MR COVERT: Q. That was the point I wanted to take up with you next, sir. I wanted to say to you this, that whether a private corporation finances through debt capital or equity capital depends on a good many things; first, I suppose, it depends on the condition of the market, the times, even the question of income tax?

A. Unfortunately, that is so.

Q. For example, I suppose it would be pretty expensive financing to try to finance entirely through common stock today, where income tax must come out before you pay the dividends on common stock?

A. That is correct. On the other hand, a concern such as General Motors Corporation, which borrowed some money several years ago, but it has paid it all off, and now has nothing but preferred and common stock; they say that they would rather not have that impact of having to pay debts possibly at a period of lower industrial activity.

Q. I was going to come to that. Now, the reason that you want this cushion, if I may call it that, of equity capital, is because when a depression comes you may lose your company if you have nothing but funded debt; there may be a foreclosure?

A. That is correct.

Q. Which cannot take place if you just have the common stock?

A. That is right.

Q. Now, in considering the position of the Canadian Pacific and the Canadian National, raising money by equity capital is no problem at all to the Canadian National;

it is something, as a matter of fact, from the point of view of the Canadian National -- would it not be fair to say that they would perhaps be foolish to attempt to raise money by equity capital?

A. Well, maybe I do not quite understand your question, sir.

Q. Can I put it this way, then---

A. You mean to sell to others than the Canadian Government?

Q. Yes.

A. Well, I would think that was a matter of national policy here, of whether you want to bring in other people than the Government as an owner of equity securities. If you do bring those people in, as I would see it, they would only come in if their position in effect was guaranteed in some way by the Government.

Q. Because of what?

A. Because of the situation as it exists as to earnings.

Q. That is what I was going to suggest to you -- because of the situation as to the earnings of the Canadian National?

A. That is right.

Q. And also because of the large funded debt that now exists?

A. That is right.

Q. Ahead of it?

A. That is right. Mr. Covert, I agree that there should be a recapitalization of the Canadian National. That is, it is not maybe for a person from the United States to say so, but I mean from a financial point of view the fixed interest charge and the $1.3 billion is large, and I would have no hesitancy in saying that if I were in the position of the Canadian National I would want a recapitalization;

but I am here appearing for the Canadian Pacific, and all I am saying is that if there is to be a recapitalization I would hope that it would result in such a fashion that the credit of the Canadian Pacific is not hurt thereby.

Q. Well, that is what I wanted to come to. I would like to say, sir, that you need have no worries about expressing your opinions because you are an American citizen; I think I could say on behalf of the Commission that we would be glad to have your views on any of these matters, based on your qualifications. Now, what I wanted to find out was this: Would it not be an entirely different position for the Canadian National, where they can raise money cheaply by the issue of bonds, much more cheaply than they could by issuing equity stock to the public, and where income tax is no problem to them, and where the fear of being unable to pay the interest on the bonds during a depression is no problem to them -- what I wanted to find out was, is not the position of the two roads in your opinion entirely different in that respect?

A. It is entirely different. They have the great background of the credit of the people of Canada and the Canadian nation behind them, whereas the other has its own credit on which it has to raise its capital.

Q. Now, coming back to my point, one problem of the private enterprise is to so adjust its funded debt and its equity capital that if there is a depression they will have that cushion; now, the ideal situation in a depression would be to have entirely equity capital?

A. Well, I do not know whether I would say it was ideal; it would be the safest position.

Q. Well, all right, we will say the safest position. But that is one factor that they must take into consideration in any capitalization that they make?

A. That is right, that is right.

Q. Now, you did say that you agreed that the Canadian National should in your view be recapitalized?

A. Yes.

Q. That is, for two reasons, I assume, sir: One, you say that the interest on their funded debt is too great based on their earning power; is that one reason?

A. I would say that based on their past and present earning power it would seem that the present fixed charges, if it were to remain fixed at that rate, while it might be covered -- and I am optimistic enough to think that it would be covered in some years -- but of the net railway operating income that would form a much larger proportion than you would want to have in a commercial enterprise, and as such those charges, some part of them ought to be -- the charges on the $1.3 billion, some part of them ought to be taken care of in some other way.

Q. Now, when you say compared with the commercial enterprise, I wanted to find out whether you thought that that was a fair comparison; should they be compared with a commercial enterprise? I am using your term.

A. Yes, I realize that, and I suppose it is rather hard to say exactly where that leads you, because they are in competition with the Canadian Pacific on the one hand, and on the other hand they are a Government enterprise. Your situation is such that I can perfectly understand the management's position in the Canadian National, and mine would be the same, that I would want my debt and my charges reduced, but I think that there you come -- and I think the position of the Canadian Pacific has been that they were not objecting at all to a recapitalization of the Canadian National that would reduce its fixed interest-bearing debt providing that there was something done which would

protect the Canadian Pacific, and I do not know just how you are going to work that out. That may mean that there is some way of providing that there will be some return to the equity holder in the Canadian National, the same way as there is some return to the equity holder in the Canadian Pacific.

Q. Now, you are aware, Mr. Northey Jones, that every time the year ends and the Canadian National shows a deficit that is headlined in the press throughout the country, and that the probabilities are that people in the country do not understand the funded debt position of the Canadian National?

A. Right.

Q. And you would agree that that probably would affect the morale of the employees of the Canadian National; would you agree with that?

A. Well, I certainly think it would have an effect upon the morale. I know I would not want to see recurring deficits in a company in which I was one of the managers. But, to look at it from the other side, if after earning $15 million net from their operations as a railway, which were just sufficient, and then you were to see in the papers, "C.N.R. has surplus of $50 million" -- 50 after 15, it would be earnings of 65 -- say if they had earnings of $65 million, and you provide the $15 charge -- "C.N.R. has earnings of $50 million" -- I feel quite sure that there would be quite a reaction about why should these rates be so high, without the realization on the part of the careless reader, let me say, that that $50 million that would be earned and that would be labelled surplus in the newspapers, was based on a recapitalization of the railroad, would be only a -- well, let's see: it would be with a net debt of $300 million, $1.7 billion, that $50 million would be only about 30 per

cent that the investor, the Canadian taxpayer, would be getting as a return on his investment.

Q. As I say, then, from your point of view your theory is that there may be large surpluses?

A. Well, I hope there will be considerable surpluses over and above the $15 million.

Q. Now, the Canadian National, as you know are not optimistic; they say that on this recapitalization on the average the surplus will be zero.

A. Well, they ought to be able to forecast that better than I can, much better. All I see is that in this decade, in the fifties, while it may be true that the percentage of transportation which is carried by our railroads in the United States -- and I presume that would be true in Canada -- the percentage of the total transportation which is carried by rail will be less, I still believe that the ton miles carried in the United States in the fifties will be greater than any decade other than the forties, and I think in Canada your ton miles moved -- although those ton miles will be a smaller percentage of the total ton mile movement in Canada, yet actually the ton miles carried by the Canadian National I would believe would be greater than in any other decade except the forties, and with your expansion here in Canada and your economic growth I do not think it unreasonable to think that your fifty decade in ton mile movement may exceed the forty decade.

COMMISSIONER INNIS: Q. Would you care to say how much you think the capital should be reduced, or how far you would go with it?

A. I think that is very hard, Dr. Innis, unless you make a specific study. We have had great trouble in the United States in this matter in railroad reorganizations.

Some of them -- the Missouri Pacific went into bankruptcy I think it was in 1933, and we have been working seventeen years trying to get that reorganization straightened out, and there has been a continuous fight in the courts and before the Interstate Commerce Commission as to how much that should be cut down and whether the old equity owners should be frozen out completely or whether there is a little bit left for them.

Q. Well, could I come at it in another way? Would you care to say what you mean by a strong, healthy and dynamic C.P.R.? -- because there is a great range of views -- in the main that the C.P.R. should be kept alive. Nobody quite knows what that means; I suppose it ranges all the way from oxygen treatment to something which is very vigorous and very energetic. The whole question is, just how much alive the C.P.R. should be kept.

A. Well, as I see it, one of the phases, I have tried to point out, one of the phases of keeping alive and dynamic, I mean not being sick and gradually petering out---

Q. Nobody wants that.

A. Nobody wants that; but to be alive and dynamic and progressive they have got to spend money on these properties, and to spend that money they have got to raise that money, and to raise that money there has got to be a wage paid to that capital, as I see it, that is commensurate with the wages paid to capital which is given to pipelines or to shipping companies or to mining operations, also taking into account the risk. Now, in a utility industry, where you have expansion, in the electric industry, it looks today as if the risk was not as great as in the railroads. Back in the twenties people thought that the risk in the railroads was not great, and they were able to get their capital at a little better rates than the public utilities. Now they

cannot get it at as good rates as the public utilities. But if you could remove that jeopardy of fear that the rails are declining, if you can put the Canadian Pacific so it can get money -- it has a diesel programme, it has a programme for modernization of yards, and all these programmes mean a lot of savings. In the United States we have spent almost $4 billion on our railroads in the last four years. About $1 billion of that has been for locomotives; that is about a quarter of the $4 billion, and most of that has been for diesels. and those diesels mean big savings.

Q. You have not really changed your views, then, from the six and two-thirds per cent that you mentioned?

A. Well, in the United States recently there have been a lot of views expressed that the railroads ought to be allowed to earn 6 per cent on their property investment, and back in 1920 that was the original figure that was given that the I.C.C. used as a theory in rate-making; and then that theory was taken out. I mean, they never -- well, they have in one or two years got the 6 per cent -- they got the 6 per cent in one year during the war recently -- but in 1948 it was four and a fraction per cent, last year it was something under three, and we have had a much greater increase in rates, of course, than you have up here, in the United States.

MR COVERT: Q. On page 16 of your statement, sir, you say that earning power should be restored, and you go on to say:

> "Earning power is dependent upon physical volume of business, rates, expenses and charges."

Now, I suppose there are several opportunities there to make adjustments one way or the other; for instance, you may increase the volume of business?

A. Then you usually get a lower unit cost; you should.

Q. Then you may possibly be able to reduce your expenses and charges?

A. That is correct. These capital improvements I was talking about, is one way of reducing your---

Q. And the other is to raise rates?

A. That is correct.

Q. Now, you ---

A. There are situations where you might get more by a reduction in rates, but I don't want to get into that.

Q. In that same paragraph, just before I leave it, I want to ask you about this. It is near the end of that same paragraph; you say:

> " . . . may exceed all decades except the 40's, and in Canada, due to the relatively steady growth in economic activity and less truck competition, may well exceed the 40's."

Am I correct, that you mean that there is less truck competition in Canada now than there was?

A. No; less truck competition than in the United States, that means.

Q. Oh, I see.

A. I am sorry if that was misleading.

Q. It may be---

A. In other words, I say that in the United States I think in this decade of the fifties that will surpass all other decades except possibly the forty decade, the decade of the war. Here in Canada I would certainly say that your ton miles up here would be greater than any decade except the forties, and I say up here in Canada you have a chance of surpassing the forties, because you have less truck competition than we have in the United States,

and because your expanding economy is steady, and you may well have more ton miles in the fifties.

THE CHAIRMAN: We will adjourn now.

---The Commission adjourned at 1:00 p.m., to meet again at 2:45 p.m.

Ottawa, Ontario
Monday, April 24, 1950.

AFTERNOON SESSION

MR. ALLEN NORTHEY JONES - Recalled

COMMISSIONER ANGUS: Q. May I ask this question while we are on page 16? If I understand it, the argument is that if the Canadian Pacific has to make a greater investment, has to enlarge its capital, then you have to consider what wage for capital is necessary to raise that money in the market?

A. That is correct.

Q. And then you have to really see that all existing shareholders, get a similar wage, the older shareholders, and that the revenues of the Canadian National too are correspondingly extended?

A. I think that is so, Dr. Angus. There is always that question of whether it is exactly a similar wage that the old investor put into the property. I mean because of the ups-and-downs of the economic cycle he may have put in a different figure than is put in now, but the wage should be such as may be not the absolute integrity if he invested it in a boom period, but in average that the integrity of his investment is maintained, as well as the wage that is paid on the new capital.

Q. So that the effect might be, I think, to have quite an appreciable increase in railway rates in order to enable the Canadian Pacific to acquire a relatively small amount of capital?

A. That, Dr. Angus, in the case of the Canadian Pacific, just the extent of that increase in rates, is a question. There is not only the increase in rates, but there are the economies in operation and there is the possibility of

a growth in business in the number of ton miles hauled. In addition, in the Canadian Pacific they are, in a way, in a fortunate position in having a substantial Other Income, and the market price of their stock is dependent not only on the rail income, but also a big factor in it is what they get from Smelters, so that actually to sell Canadian Pacific stock at 25, the ability to do that may be helped greatly by the Other Income coming from Smelters.

Q. Yes, but that is not increased at this time?

A. No.

Q. I mean if you start at 17, you have to climb to 25?

A. That is right.

Q. By means of freight rates, and volume?

A. r' volume.

Q. But in so far as you do it by volume, if you are not having an increase of rates, you are at least avoiding any decrease in rates that might otherwise occur?

A. Yes.

Q. What I want to get is this: from the standpoint of national policy, you might imagine the government saying: "that some people have a fear of increased rates, and we would like to spare them that, avoid that, and that could conceivably be done by making funds available to the Canadian Pacific in some other way. To take just a crude example, it would be conceivable that the Government itself might buy the common stock of the Canadian Pacific authorized but unissued at par - at $25.00, and then say the Canadian Pacific has adequate funds and the rates will not have to be raised, and as far as we are concerned, we get the old dividend but we can borrow the money that we have to supply and break even or a little better than break even. Now, would

you consider an arrangement of that sort -- and if this is not a fair question, do not answer it, -- would you consider that an arrangement of that sort was unfair or unjust to the existing shareholders?

A. This is my own opinion. I would not think that an arrangement of that sort would, of itself, as far as a financial transaction, be unfair. The question might arise that if the Government were to buy this stock at 25, would they expect to get a return on that? If the situation were to arise that the Government would not expect to get a return on that, and by their not expecting to get a return on that $25.00 per share they put in, resulted in the other common stockholders not getting a return on that investment, I believe that the other stockholders would feel that they were not in a good position.

Q. I can see that. But for the Government to expect to get something of the order of 4% does not require as high a level of rates as for the stockholders in general to expect to get something of the order of 6 2/3%?

A. That is correct, sir. My lord, there was one thing that you asked this morning about depreciation as to the division on Class 1 railroads in the United States between as between road and equipment. In 1948 the depreciation the amounts of money that were provided for depreciation/on road and amortization of road defence projects amounted to $126 million and the depreciation on equipment and amortization of equipment defence projects amounted to $265 million so that of the total depreciation provided in that year by Class 1 railroads 32.3% was on road accounts and 67.7% was on equipment accounts. Similarly --

THE CHAIRMAN: Q. What is the year? 1948?

A. 1948. Similarly in 1949, for depreciation of road

and amortization of road defence projects the amount provided was $130 million, and the depreciation and amortization of equipment defence projects was $295 million so that the percentage of total depreciation provided for road was 30.5% and that proportion of total depreciation provided for equipment was 69.5%.

EXAMINATION BY MR. COVERT: (Cont.)

Q. With respect to those, Mr. Jones, would you say that through the years the figures have been somewhat near that?

A. Well, of course, depreciation of road is relatively new with us.

Q. It was 1940, was it not?

MR. CARSON: 1942.

THE WITNESS: 1942, I think it was.

MR. COVERT: Q. Have you checked the figures from 1942 on to see whether the percentages were somewhat the same?

A. I did not do that this noon. I think you will find in the earlier years that there was not quite as large a percentage on road. That has increased, although with the increased amounts of equipment which has been bought in recent years that has tended to keep the equipment percentage high also.

Q. I want you to turn to page 18 of your statement on which page you are dealing with the possibility that in some respects Canadian National might become the yardstick in rate matters, and you say:-

"Indeed there is a serious question whether the Canadian Pacific could remain the standard if

the Canadian National were granted the relief has requested and is not required to use earnings over and above its reduced fixed charges to pay a return on its equity capital."

Why do you say that there is a serious question?

A. It would seem to me from what I have read of the proceedings here and the proceedings before the Board of Transport Commissioners, and from what I would judge would be the reaction to people reading the newspaper, if it were published, that the Canadian National had an appreciable surplus from operations during the year, that certainly the Board of Transport Commissioners have raised the question as to whether the Canadian National shall not be used as a part of the yardstick, I think that I am not misquoting Mr. O'Donnell, that the Canadian National, while it has not been the yardstick, had to be considered. I believe, also, that the public, if they were to see one road was to have a large surplus, would say, "Why should that surplus be left out of consideration in fixing rates?"

Q. The seriousness then lies in the possibility of the Canadian National having a surplus?

A. That is one phase of it. I also said in this statement that in case there were low earnings and it became necessary for the Canadian Pacific to ask for a rate increase, it might well be that if the Canadian National were just covering their $15 million of net charges that they then might not wish to go along with the Canadian Pacific on its request for the increase.

(Page 20504 follows)

Q. Now, could we put it this way, that in effect what you say is that nobody can perhaps really forecast the future, and that there is this possibility, and that is what you say must be guarded against?

A. Yes, and I think it is both ways. In other words, if we have a very favourable situation there would be the pressure that rates be reduced, and if we have a low level and the C.N.R. just barely meeting the $15 million of net charges, then they might not wish to go along with the request for increased rates.

Q. Now, on the same page, page 18, where you are dealing with the return of 6-2/3 per cent, which you say in the 20 per cent freight rates case you testified was in your opinion the minimum wage necessary to attract new equity capital to the enterprise, then you go on to say:

> ". . . it seems reasonable to suppose that the Canadian National, with its larger system and greater gross revenues, should earn at least $50 million a year before income tax."

Now, I just wanted to check with you on that as to how you arrive at that figure. Did you say, assuming rates were such that they gave the C.P.R. a return of 6-2/3 per cent, that would give the C.N.R. a gross at least of $50 million? Does that mean $50 million available for fixed charges?

A. No; that $50 million meant -- yes, $50 million available for fixed charges.

Q. Now, could you tell us just roughly how you arrived at that figure?

A. Well, I think it would be rough. From $500 million of gross revenues of the Canadian National, to earn that $500 million would be earning just 10 per cent of gross, which would mean an over-all expense

ratio of 90 per cent, and it would seem to me that there ought to be some -- that that is not out of line, to think of a railroad being able to operate on a 90 per cent expense ratio. I mean, that is one rough way of checking the figure of $50 million.

Q. I think perhaps in the 20 per cent case you went through the question of what it would mean in the way of raising rates to yield that 6-2/3 per cent to the Canadian Pacific?

A. Not in the way of specific rate increases. The request of the Canadian Pacific -- and I think I am right in saying the request of the Canadian Pacific at that time to cover their requirements was in the neighbourhood of $50 million of requirements. This has been whittled down, I believe, by the Board to about $47.5 million, but that request was to get $50 million, and I said that I thought that request -- if they were even to get that request that would not in my opinion be enough to attract equity capital to the venture. In other words, there had to be more than the $50 million of requirements that they were requesting to the extent of another $16 million to improve the position.

Now, since that time I might say this -- and I think you asked me the question this morning, did I think that was the same figure -- there has been some increase in railroad stock prices in the last year and a quarter, so that these figures do not come out exactly the same. Also, I forget who it was asked me this morning as to whether that 6-2/3 --

Q. It was Dr. Innis.

A. Dr. Innis, yes. -- still held, and I think I remarked in regard to that that there were recent representations by some of the people in the A.A.R. in

the United States that they ought to be allowed to earn a 5 per cent return. That is the difficulty of getting down into the exact argument of whether it should be 6 or 6-2/3 or 7.

COMMISSIONER INNIS: Q. Mr. Frawley, as I remember it, argued for 5 per cent; how would that work out?

A. Well, 5 per cent would work out just about what the Canadian Pacific requested in the rate case. In other words, a 5 per cent on the approximate billion dollars of investment was about the $50 million requirement that they asked for.

Q. What would that leave the Canadian National?

A. I am afraid that I do not have the figure, Dr. Innis. The corresponding figure that had they been granted this full 20 per cent -- can I have somebody look that up?

MR. COVERT: Q. I just wanted to find out, Mr. Jones, you would not suggest -- I do not think you hold out yourself as being an expert to say that freight rates can be raised sufficient to enable the Canadian Pacific to earn 6-2/3; all you say is that in order to sell common stock there should be a return of that?

A. That is correct; but on the other hand I see the situation here as compared with the United States, and your increase in rates up in Canada has not been equivalent by a considerable degree of what we have raised them in the United States.

Q. Well, there would be different considerations that would apply in both countries?

A. That is right.

Q. Now, the next thing: you gave an illustration

this morning by taking I think 5 per cent on the gross receipts of the Canadian National on approximately $500 million; you said, well, that is $25 million, and then you took 5 per cent on the Canadian Pacific of $360 million, and that worked out to $18 million, and then you deducted approximately a third from that for income tax, which left them about $12 million, and you showed that that left them in the position that increases gave approximately two dollars to the Canadian National as compared with one to the Canadian Pacific. Now, I think you would be aware that the percentage would not apply to the full $500 million?

A. That is right. I believe I said a straight across the board percentage, and it would be different in different kinds of rates. You have your fixed rate on wheat, and then passenger might not be the same, and --

Q. That illustrates, does it, what happens even after you take those out?

A. That is right, because I would imagine that in the different classifications of revenue the Canadian National has larger revenues more or less in the same different classifications.

Q. Now, on that same page, at the very last part of the paragraph, about six lines from the bottom of the middle paragraph, you say:

> "Even if the Canadian Pacific were still the yardstick for rate matters it is hard to believe that if such a sum were to accrue each year to the Canadian National, there would not be a strong demand from many people for lower rates, or even a demand that the Canadian Pacific no longer remain the yardstick."

Now, I wanted to know if you had given any consideration

as to what in your opinion the Canadian National should be allowed to keep by way of surplus?

A. Well, I do not think that I ever tried to reduce that to a figure, but I think that possibly the example of some of our reorganizations in the United States might be considered up here, and that is, that a certain amount be allowed as a capital fund and that then after that there be income bonds, which would be given to provide for a return, in this case to the Government after the prior allocation of a sum for additions and betterments, and those figures in the United States, I think those capital funds vary somewhere in between 1-1/2 and 4-1/2 per cent. At a 3 per cent figure for the Canadian National that would be about a $15 million capital fund which they would be allowed to take, and would be counted before figuring any income available for income bond interest.

Q. Now, just one more question. On page 20 in the last paragraph you say:

> "If the wage required to be paid on Canadian National capital is reduced to approximately $15 million, which is only some 3 per cent of its gross revenues and only about 1 per cent of the capital invested in the enterprise, my firm opinion is that the Canadian Pacific would be put in a disastrous position and great disservice would result to the people of Canada."

Now, I just wanted to make sure that I found out how you arrived at those calculations. You have taken 3 per cent of approximately $500 million, which is --

A. Three per cent of gross.

Q. Approximately the gross for the last year?

A. Yes.

Q. That gives you your $15 million; and your one per cent -- what have you done? Taken about a billion and a half?

A. Well, there you get into the realm that we were talking about possibly this morning, as to how much depreciation or write-down might be made in the assets in reduction of the net property account. It is some $2 billion now. If the figure is $2 billion without any change it comes out at three-quarters of one per cent. If they were revalued at some figure as low as a billion and a half -- and I do not say that that is the right figure -- it would be one per cent, so that it is somewhere in the neighbourhood of somewhere between three-quarters of a per cent and one per cent.

Q. Now, Mr. Jones, you have read, I presume, the Canadian National submission in this matter?

A. Yes.

Q. And I think they say that this does not cost the Government anything -- that is, their proposal to recapitalize?

A. I did not recall that exact statement, and I do not know --

THE CHAIRMAN: Mr. Covert, could you give us that reference, so that we may see the context of it?

MR. COVERT: I think in the brief, in the submission itself, which did not contain the proposal about the $300 million, Mr. Chairman --

THE CHAIRMAN: You are referring to the volume?

MR. COVERT: Yes.

THE CHAIRMAN: Whereabouts is it in that?

MR. COVERT: I am just trying to find it. On page 63 they say:

"The adjustment proposed would not cost the Government any money. As the sole shareholder any gain or loss is for account of the Government."

A. Well, the immediate cost is expressed in the fact that there is $760 million of what is now classified by the Canadian Government as an active asset, I presume taken from the field of active assets. Now, it is conceivable that that would not be done, and that an equivalent amount of equity would be considered as an active asset. I would think that that would only follow, that they could change this from debt to equity and still continue it as an active asset if there was a return being paid on that. In other words, the immediate cost to the taxpayer of Canada, as I see it, is providing for an increase in debt as far as the $760 million, in the net debt of the Government of Canada, of $760 million, and providing for the interest on that.

Similarly, as far as the $300 million is concerned, the Government of Canada and the taxpayer has to pay or has to provide $9 million a year, so there is an immediate cost. Well, you might say, or it might be argued, well, there is not any cost, because the Government of Canada is not receiving the interest on that $760 million anyway, they are having to provide the money to pay themselves the interest. That is where I think again we get into this position vis-a-vis the Canadian Pacific, where the Canadian Pacific must earn on its equity, and where, as has been expressed up here before, it is reasonable to think that there should be some return on the equity that the Government has, so that unless the situation is so remedied here that the railways can earn a rate of return on that equity capital for the Government, then the burden of carrying

the traffic is shifted from the shipper to the taxpayer. Now, that is shifting it from one class to another class, and they are the same people in many instances.

Q. Let us forget the $300 million for the moment and take the original proposal. The Canadian National does suggest that this does not cost the Government any money. I suppose that is a fair argument, Mr. Jones, if you say that since the Government owns the entire Canadian National what they take out of one pocket they put in the other, and if that were so, and if it had the desirable effect of improving the morale of the Canadian National employees and perhaps enabling them more efficiently to operate the railroad, then if it had no adverse effect on the Canadian Pacific would you not say that that would be a simple and effective manner of improving the morale and harming no one? Now, I put that provision in -- if the Canadian Pacific were protected.

A. Well, if I were shooting at a target I would rather have a target of a little more than $15 million, I believe.

Q. Well, then, you are getting down to the question of whether or not there is sufficient interest requirements left to give them a real target to shoot at?

A. That is right; and when I get into that, that is awfully hard to say, just where the dividing line lies, and when I said that I did not give you a fair answer, I am sorry, because you said leaving out the $300 million and the $9 million.

Q. That is right.

A. And if you left that out it would be $24 million or $25 million.

Q. Yes.

A. So that you are in the range of where something

might be done about the $760 million.

Q. As I say, if it does not cost the Government anything, and if the Canadian Pacific could be protected, would you not think that this might be a good thing to do?

A. Leaving out the $300 millions?

Q. Yes.

A. Yes.

Q. Then as far as you are concerned, on that basis the only problem would be any protection that would be required to the Canadian Pacific?

A. That is correct.

Q. And you say, I suppose, that they are entitled to that protection so long as it is the policy in this country that there should be a private enterprise running a railroad?

A. Yes.

Q. That is all, thank you.

CROSS-EXAMINED BY MR. MacPHERSON:

Q. Mr. Northey Jones, in giving your evidence I understand that your purpose is first to express your opinion against the proposed recapitalization plan of the Canadian National?

A. Mr. MacPherson, I would say that it is not quite as straight opposed to the recapitalization plan; it is opposed to the recapitalization plan without adequate protection for the Canadian Pacific.

Q. Well, I am talking of the plan as we have it; the plan as submitted by the Canadian National is the plan that you fear is dangerous to the Canadian Pacific?

A. That is so.

Q. But then you go further in your submission and you give what in your opinion the earning power of the

C.P.R. should be in order that it be, to use your words, a strong, healthy and dynamic transportation agency?

A. Yes.

Q. Now, I am one of these people to whom Dr. Angus referred, who is a bit disturbed at the idea of higher freight rates, as you will remember from a year ago, Mr. Northey Jones. You make it clear, I think, in your submission that rail revenue should earn certain money so far as the Canadian Pacific is concerned?

A. Yes.

Q. And in the last analysis rail revenues mean freight rates, what comes from freight rates?

A. Not altogether. I mean, there are savings that can be made. It is not purely a question of rates; it is a question of efficiencies --

Q. Well, these efficiencies enter into operating expenses, into what I think the Canadian Pacific called working expenses?

A. That is right.

Q. That is where that comes in?

A. Right.

Q. But in the last analysis, as you know, there is no money made, or so the C.P.R. tells us, on passengers?

A. I believe that to be the case in the United States, and I understand it to be here in Canada.

Q. So that it is the revenue from freight in the last analysis that is going to furnish your earning power?

A. That is right.

Q. Now, you tell us in your submission at page 7 of an inspection trip you had made over the Atlantic Coast Line recently; actually you have made

[illegible] should be in order, is it so, do you your words, [illegible], healthy and [illegible] [illegible]

A. Yes.

Q. Now, I am [illegible] to show Dr. Angus referred, [illegible] subscribers to the [illegible] of higher weight water. Do you [illegible] remember [illegible] a year ago.

Mr. Hershey Jones. Yes [illegible] clear. I think, is your [illegible]

[illegible] 2 [illegible] Pedal. [illegible]

A. Yes.

[illegible]

[illegible] water [illegible]

A. Not altogether. I mean, there are things that can be made. It is not merely a question of water. It is a question of [illegible] water.

[illegible] working [illegible]

A. That is right.

Q. That is [illegible] that [illegible]

A. Right.

Q. And in this last analysis [illegible] no money [illegible]

A. I [illegible] the [illegible] Stations, and I am [illegible] be [illegible].

Q. [illegible] Last analysis [illegible] over?

A. That is right.

[illegible] your subject [illegible] an [illegible] you have made over [illegible] [illegible]

no inspection trip over the Canadian Pacific?

A. That is correct; I have not. I have ridden over it, but not in a business car and having explained to me all the --

Q. It was a pleasure trip and not a business trip?

A. That is correct.

Q. That would be right, Mr. Northey Jones?

A. That is right.

MR. EVANS: Always a pleasure to ride on the C.P.R.

MR. MacPHERSON: Yes, and sometimes on the Canadian National, too.

MR. O'DONNELL: He has not inspected the C.N.R., either.

MR. MacPHERSON: Q. Have you inspected the Canadian National?

A. No, I have not.

Q. And have you ever ridden for pleasure on the Canadian National?

A. Yes, I have.

THE CHAIRMAN: Q. Did you get the pleasure?

A. Yes, I did.

MR. MacPHERSON: Q. To what extent are you familiar with the Canadian National as a system?

A. Well, I would say that I have studied the annual reports, read the annual reports, if you will, as they came out; I have talked with the Canadian National people in respect of these figures that we put in the registration statements for the S.E.C. About two months ago I think Mr. Cowie of the Canadian National came into my office to talk about a problem which he has in respect of the Chicago and Western Indiana. It is a terminal company in Chicago which is owned by five railroads of

[illegible]

[illegible] Thank [illegible] seconds, I have one. I have [illegible] but not in a business [illegible] we all know --

[illegible] I was [illegible] learning this [illegible] a business [illegible]

[illegible]

[illegible] Mr. [illegible]

[illegible]

Mr. [illegible]: Have a [illegible] in [illegible] the C.P.R.

Mr. MOORE [illegible]: Yes, and [illegible] the [illegible]

Mr. CLIFFORD: He [illegible] the G.N.R. [illegible]

[illegible] Have you [illegible] the [illegible]

[illegible] No, I have not.

[illegible] And have you [illegible] for pleasure on the Canadian Northern.

A. Yes, I [illegible]

[illegible] Did you get the [illegible]

A. [illegible]

[illegible] [illegible] any [illegible]

[illegible] [illegible] system

[illegible] I have studied the [illegible] country, if you will.

[illegible] with [illegible]

[illegible] the C.P.R. [illegible] by morning [illegible] think Mr. Dowie or the Canadian Northern [illegible] my office to talk about a problem which [illegible] of the Chicago [illegible] country to Chicago which [illegible] and by five

which the Grand Trunk was one of the owners. It is the C.N.R.'s entrance into Chicago, and they have a $50 million bond issue maturing in 1952, and they are trying to figure out -- my knowledge is not of every section of the Canadian National, but there are problems that come up like that one which have come to my attention.

Q. Mr. Jones, speaking for a moment on this registration, actually, having regard to the fact that Canada as a nation was on the note -

A. Right.

Q. -- you were not as much concerned with the capital structure of the Canadian National system as otherwise you might be?

A. That is correct.

Q. That is quite correct. And consequently you probably did not inquire and probably you have not been told of the certain uneconomic lines that have to be carried in the capital structure of the Canadian National?

A. Well, I would say that back in the thirties when we were preparing these registration statements I talked for days about two big problems. One was wheat, and one was the C.N.R., and those were both factors. As to the wheat, I would say that the drought and the bad position of the Prairie Provinces was the biggest single factor that would worry an investor about buying Canadian Government bonds at that time, and had to do with a difference in the price probably that the bonds sold for as a result of the unfortunate position of the Prairie Provinces.

Q. Now, Mr. Jones, just a minute on wheat. It was not only the question of drought, but it was the question of price for wheat in world markets once the wheat was produced there?

A. That is right, and that got into the wheat policy and the purchasing by the Wheat Board.

Q. Now, just on that point of the Canadian National, what you know of it, do you know anything of the Newfoundland Railway?

A. I have ridden from St. John's to Port au Basques over it, and that was not a pleasure, Mr. MacPherson.

Q. So you would be quite prepared to consider that that would be a non-earning line?

A. I do not see how it could earn money.

Q. Now, you have never been on the Halifax and Southwestern, have you?

A. No, I do not know that.

Q. Have you ever been on the Temiscouata?

A. No.

Q. Have you been on the Grand Trunk Pacific from Nakina to Quebec, we will say, which is quite a long distance?

A. No, I have not.

Q. On the Grand Trunk Pacific from Red Pass Junction to Prince Rupert?

A. No.

Q. I suggest to you that these are all uneconomic branches of the Canadian National and that a burden has to be borne by the Canadian National treasury in respect of the operation of these lines. You will realize there are a number of such lines?

A. Well, there are -- from the statistics that I have seen I would imagine that there are a number of such lines, but I could not of my knowledge, because I have not seen them, say I thought that these specific lines which you have mentioned are uneconomic. I mean, I have heard it argued that the line to Prince Rupert

may not be, but that is another question.

Q. Mr. Northey Jones, when you came up here a year ago giving evidence on the rate case you found that the Canadian Pacific was being taken as the yardstick?

A. That is correct.

Q. And you know that it was argued that the Canadian Pacific should be taken as the yardstick because of the hopeless capital structure of the Canadian National?

A. I did not remember the word "hopeless" being used.

Q. Well, some other adjective will do. You knew that was the basis for the Canadian Pacific being taken as the yardstick, because of the capital structure of the Canadian National?

A. On a requirements basis that was being used, that that was the reason.

Q. And yet it never occurred to you to consider what by way of rearrangement should be made in the capital structure of the Canadian National?

A. Well, as I understood it at that time, and when I came up to testify a year and a quarter ago, so to speak, the rules of the game were set, and it was not in my province to try to argue with the Board of Transport Commissioners that the rules which they had set down -- here I was, an outlander from the United States -- that they should change their rules.

Q. Now, I appreciate very much your attitude in that regard, Mr. Northey Jones, but may I suggest this to you, that in your submission here today you have indicated that, looking at the situation of the C.P.R., you would be worried about the C.N.R. with earnings of $50 million, as you said just a little while ago. Now, is there any point at which you would

[illegible]

A. No. [illegible]

Q. Giving evidence [illegible]

A. [illegible]

Q. [illegible] I [illegible] I [illegible] should be [illegible] on [illegible] of the [illegible]

A. I did not [illegible] when we [illegible] when.

Q. Well, [illegible] collective will [illegible]. You know the [illegible] the [illegible] of the [illegible] the Communist Manifesto?

A. Or [illegible] requirements [illegible] that [illegible] living [illegible].

[illegible]

when I [illegible]

[illegible]

had not [illegible]

[illegible] Now, [illegible]

[illegible]

[illegible] you, then [illegible] indicates that, looking [illegible] would be [illegible] conditions of [illegible] as you [illegible] will [illegible] Now [illegible]

not be worried? You would be worried if the earnings of the Canadian National were $50 million, with this scheme?

A. With that scheme.

Q. Yes. Now, is there any point -- would it be forty, thirty, twenty, ten million dollars, at which you would cease to have any fear?

A. I would not have the fear even with the larger figures if, for instance, the situation were to exist with the Canadian National that exists with a number of our reorganized railways, where, as I said, there was a capital fund of some reasonable amount, figured out about what it should be, that that would be allowed to be retained and spent for additions and betterments, and that the income after that went to pay interest on income bonds. Now, certainly you can get down to a figure that if the Canadian National has earnings of $5 million over and above these charges of $15 million, I do not believe that that would be the basis for asking for a reduction in rates.

Q. No; what I am getting at is, you have suggested $50 million as a figure that would worry you?

A. That is correct.

Q. What is the minimum figure that would worry you?

A. Well, if it gets down in a minimum figure I am worried from the other point of view, that then if only that minimum can be earned on the Canadian National, then the Canadian Pacific may not be in a position to earn its requirements, and in going and asking the Board for an increase in rates, that the Canadian National may not go along with them on it, and you get into a position where it would be unlikely that the rates would be increased.

Q. Well, it is going to be difficult to relieve you

of worry, then, Mr. Northey Jones.

A. I am afraid.

Q. Now, you refer on page 15 of your submission to the investments of insurance companies. Actually these figures of your own show that the Canadian insurance companies have more money invested in railway securities today than they had in 1929?

A. Yes.

Q. $4 million more.

A. The $4 million more, that of course is a very small figure, though, a half of one per cent of their total assets.

Q. Now, Mr. Northey Jones, how much financing has the Canadian Pacific done in a public way in the last twenty years?

A. Well, in the last twenty years I would have to look it up, but I mean it has not been --

Q. I suggest to you that apart from equipment trusts the Canadian Pacific has done no financing?

A. Well --

Q. Apart from the $20 million.

A. Well, then there have been some other collateral issues also.

Q. Well, I mean collateral trust issues.

A. Well, that is a way of raising money.

Q. Do the insurance companies in this country buy these?

A. Yes.

Q. To your knowledge?

A. Oh, yes.

Q. In Canada?

A. Well, I do not think they have bought very many. The record here shows they have not bought very many, but

it is a good type of security; they are secured by Canadian Pacific perpetual debenture 4's and the difference between --

Q. I know how they are secured. I am only asking you --

THE CHAIRMAN: Q. Would you please complete that, Mr. Northey Jones?

A. I say they are a good type of security. The collateral are Canadian Pacific perpetual debenture 4's, and by buying these collateral trust bonds they obtain a bond which has a definite maturity, and in their investment policy they like to have that rather than buying a perpetual bond which is subject to more fluctuation.

MR. MacPHERSON: Q. Do you know whether or not, as a matter of fact, these equipment trust obligations are purchased in Canada by the insurance companies?

A. I think not to any large extent; I do not know, as a matter of fact.

Q. I think not. As a matter of fact, the Canadian Pacific, apart from their equipment trust obligations --

A. That is right.

Q. -- have, I suggest to you, in the last twenty years had no security offered to the public at all.

A. Equipment trust and collateral trust issues?

Q. Yes.

MR. COVERT: Mr. Chairman, it seems to me, it may not be clear that they are not talking about two different things. I think Mr. Jones is talking about collateral trusts, and my friend is talking about equipment trusts.

THE WITNESS: Maybe, my lord, I might explain that. To finance the cost of the purchase of new equipment there are securities sold which are called equipment

[illegible]

[illegible] I believe. I'm and the life-

[illegible]

[illegible] I know how [illegible] assumed. I am only [illegible] you -

MR. [illegible]: Would you [illegible] mind [illegible]

[illegible]

[illegible] a [illegible] bunch [illegible] be burned these coal beds burn [illegible] obtain [illegible] which [illegible] dedicated [illegible] in their invest-ment policy they like [illegible]

[illegible]

[illegible]: [illegible] you [illegible] or not, [illegible] of [illegible] Shaw equipment trust [illegible] [illegible] in Omaha [illegible] the insurance company?

[illegible] I think [illegible] my [illegible] [illegible] I do not know.

[illegible]

[illegible] I think not. [illegible] matter of it [illegible] the Omaha [illegible]

[illegible]

[illegible]

[illegible] [illegible] property [illegible] the public [illegible] all.

[illegible] equipment [illegible] [illegible] Shaw's [illegible]?

[illegible]

[illegible] [illegible] I [illegible] to me. It [illegible] [illegible] that [illegible] talking about the life-[illegible] thing. I think Mr. Jones is talking about [illegible] investment, and my friend is talking about equipment [illegible].

THE CHAIRMAN: Mr. [illegible], I might [illegible] in this. The Pioneer [illegible] cost of the [illegible] [illegible] the [illegible] sulphuric acid [illegible] [illegible] [illegible]

trust certificates. These are sold under different plans, in which the title may rest in a trustee, and the railroad using them pay rent in the form of interest and principal payments, and when the principal payments have equalled the total principal amount of the debt the title then passes from the trustee to the railway.

THE CHAIRMAN: Q. The title of the implement?

A. Yes, the title to the cars or the engines or whatever they are. A collateral trust obligation, on the other hand, is an obligation which a railroad sells and then pledges underneath that certain other securities or stocks, bonds or securities, as a collateral pledge. Now, the Canadian Pacific in addition to the equipment trusts that they have sold in recent years, have sold some issues of collateral trust bonds, where the collateral has been another bond of the Canadian Pacific Railway, the perpetual 4 per cent debentures.

MR. MacPHERSON: Q. Mr. Northey Jones, you have on page 13 set out in the last four years that there was $32 million by the Canadian Pacific in 1946, and $37 million in 1948?

A. Those were all equipment trusts.

Q. These are lien agreements and that sort of thing?

A. That is right.

Q. And do you know when the last collateral issue was?

A. Well, the last collateral trust issue was this recent one of the 3-1/8 a month ago.

Q. And that was the first new money that was taken, that was obtained; anything else that was done by way of collateral trust would be by way of financing existing --

A. Refunding.

Q. Refunding?

A. Yes, refunding.

Q. Refunding existing obligations?

A. That has been true since 1941.

Q. And of this $20 million that was sold recently, these 3-1/8ths, with the feature that they might be converted to common stock -- do you know how much of that was taken up by the life insurance companies, if any?

A. No, I do not know that.

Q. You do not know?

A. No.

Q. Now we come to a part of your submission that I am particularly interested in, and that is at page 18. On page 18 you say this, Mr. Northey Jones:

> "If the Canadian Pacific is to remain the standard in rate matters, and rates are set so that Canadian Pacific could earn after income tax an amount somewhere between the $47,500,000 requirement set forth in the February 28, 1950, judgment of the Board of Transport Commissioners, or a return of 4-3/4 per cent on the approximate billion dollars of capital invested in the railway enterprise, and the $66,600,000, a return of 6-2/3 per cent, which in the 20 per cent Freight Rate Case I testified was in my opinion the minimum wage necessary to attract new equity capital to the enterprise,"

and so on. Now, there you say that a figure somewhere between $47,500,000 and $66,600,000 -- what would that figure be, in your opinion?

A. Well, in answer to similar questions I said that that would -- if you look at it from one point of view it may be one figure, but if you look at it from another point of view it may be another figure. In my approach to it a

year and a quarter ago and in my approach to it now, as an investment banker, I look at it as what is the figure which is necessary to attract capital; and capital, as I pointed out a year and a quarter ago, in proportion, a certain proportion of debt and a certain proportion of equity capital. And, as I think I stated earlier this afternoon, there has been some change in the security market, so that the figure that I suggested of 6-2/3 a year and a quarter ago may be slightly different from that today.

Q. Well, how slightly? You see, this difference between $47,500,000 and $66,600,000 must be made up on your theory from rail revenue; that is right?

A. Net rail revenue.

Q. Net rail revenue?

A. Right.

Q. And that comes, as I suggest to you, in the last analysis from freight?

A. You may remember, Mr. MacPherson, that I said that there were a number of ways that that could be corrected, the net, and one of them is by lowering the operating ratio or the total expense ratio, and one of the ways of lowering the total expense ratio is -- and this is a shining example of it -- dieselization. I cited an example of the Atlantic Coast Line where they by the expenditure of some $26 million saved something in the neighbourhood of $7 million a year.

(Page 20530 follows)

Q. Can you tell me what figure you would put? You say somewhere between $47.5 million and $66.6 million. What would be the figure -- it is $19 million coming out of freight -- what figure, in your opinion, would you suggest today?

A. Well, I would say -- this is on the basis purely of being able to attract equity capital, a figure somewhere between 6 and 6 2/3%, or let us say, if you want to split the difference with me, $63 million.

Q. That is the figure you gave us today. I want to refer to the evidence you gave a year and a quarter ago, and I would like to file this as Exhibit 274, Exhibit 49-67 which was an exhibit you filed yourself in the 20 Percent Case.

EXHIBIT 274.....: Computation of earnings
: necessary to improve credit s
: standing of Canadian Pacific
: Railway.

Q. This is your exhibit, filed by you, Mr. Jones, in the 20 Percent case, and it represented your conclusions and your suggestions in respect to the Canadian Pacific Railway and its capitalization; that is right?

A. That is right.

Q. And you had there a theoretical capitalization at the bottom of the page which provided for a funded debt of $310 million, preference stock of (1/6) $155 million, with a rate of earning of 5%?

COMMISSIONER INNIS: Is there any prospect of the Commission having a look at this?

MR. MacPHERSON: I thought you had it, my lord.

Q. You had there a funded debt of 1/3 or $310 million with a rate of earning of 4%; preference stock of $155 million with a rate of earning of 5% and ordinary stock of $465 million with a rate of earning of 10%?

A. That is right.

Q. That was your suggestion?

A. Yes.

Q. On the preference stock there you put the rate of earning at 5%, whereas the preference stock today with the Canadian Pacific is being paid 4%?

A. I do not believe, Mr. MacPherson, that it sells on that basis. I am sorry to say that I haven't got the London market figures with me, but I believe it sells not to yield 4% but to yield more than that. In other words, the stock sells at a discount.

Q. That is why you have the rate of earning set at 5%?

A. That is right. At that time it was selling around 80, I believe.

Q. But it carries a 4% guaranteed payment?

A. Not guaranteed.

Q. Well, not guaranteed; 4% is what it carried, and even that was not paid.

A. That is right.

Q. At page 2578 of your evidence in the 20 Percent Case, you were asked by Mr. Carson:

"So you think that the Canadian Pacific could sell its ordinary stock at $25 a share -- is that right -- assuming the conditions to which you refer?

A. Assuming an improvement in the credit

position of the Canadian Pacific, and a re-establishment of that confidence of investors, I believe, that if you could have sustained earnings for a number of years -- I cannot be exactly sure of how many, but a number of years -- that you could get again a position of the Canadian Pacific, if it could earn 10% on its $25 par value, it could again sell stock, if it could earn 10% from its railway operations on its par value of $25, that it could again sell at $25."

That is what you said?

A. Yes.

Q. And you agree with that now?

A. Yes. One year and a quarter has gone by. The stock has increased in price during the year. I think there has been some more confidence in the situation; I mean, the lack of confidence which existed prior to the determination of the rate question -- the lag between the granting of the rate increases and the granting of the wage increases and the increase in material costs was such that it was having an impact to drive the price down.

Q. Well, there were other impacts. The Canadian Pacific Railway is a corporation after all, and the Canadian Pacific has such things as oil rights, and millions of acres of land in Western Canada. That is right too, isn't it?

A. Yes. Last year you asked me whether they did not have a million acres of oil lands. They have millions of acres of land some of which may have oil.

Q. Mineral rights, yes. Now, on page 2579, the second

paragraph you say:-

"To market a stock successfully at a given price -- and let us take par for the Canadian Pacific at $25 -- it has to be selling in the market for more than par. Because it has been the experience in our markets that, to ensure the success of a large ooblock of new shares of a new company, those shares had to be offered at a discount of somewhere between 15 to 25% under the then existing market."

MR. CARSON: Will you read the whole answer, Mr. MacPherson?

MR. MacPHERSON: I read his whole answer.

MR. CARSON: You will see what I mean when I show you.

MR. MacPHERSON: I will start at the bottom of page 2578. There is no part that I do not want to read, because Mr. Northey Jones was very definite and very specific and I will read the whole question and answer.

THE CHAIRMAN: Read what is pertinent to the question, that is all.

MR. MacPHERSON: Yes. Mr. Priest asked him -- I am sorry that I said before that it was Mr. Carson --

"Q. I am sure that the Board would be interested in your opinion as to the effect of the non-railway earnings of the Canadian Pacific upon its ability to sell common stock, ordinary stock.

A. The reason why I am bolstered in my opinion is that if the railway could earn 10% on the par value of these shares, that stock

could be marketed at $25 because there is that cushion of non-railway earnings.

To market a stock successfully at a given price -- and let us take par for the Canadian Pacific at $25 -- it has to be selling in the market for more than par. Because it has been the experience in our markets that, to ensure the success of a large block of new shares of a new company, those shares had to be offered at a discount of somewhere between 15 to 25% under the then existing market. Now, that is due to two things. One is just the market pressure of all those additional shares."

Then, you would agree with that today, Mr. Northey Jones?

A. I would say that in our markets in the United States, the discount that I mentioned as being 15 to 25% has lessened.

Q. How much should it be today?

A. It would depend upon the amount of the stock and the weight of the offering, but there have been a number of successful issues where the discount was from 10 to 15%.

Q. On page 2582 this question was asked you by Mr. Priest:-

"Q. What is your over-all figure?

A. So that over-all figure I get by adding the $12 million four to $7,750,000 of the $46,500,000, which gives an over-all figure of $66,650,000 or 7.17% on the $930,000,000 of capital security."

That is the same figure that is on here? Is that not right?

A. Yes, that is the same figure but the 7.17% refers to the $930 million of capital security --

Q. I will make that clear.
I am only tying that figure up with Exhibit 49-67, wh is now Exhibit 274, and the $66,650,000 which you mention at that point in your evidence, is the same sum which is on the bottom and it is 7.17% on the $930,000,000, the theoretical/capitalization.

A. The theoretical capitalization, but leaving out of consideration that there is approximately a billion dollars so that over and above that capital structure that you see there that theoretical capital structure of funded debt, preference stock and ordinary stock totalling $930 million, to balance the account, you would have a $70 million surplus.

Q. Take the next question:-

"What return would that be on the net investment in the railway enterprise as shown by Exhibit (49)-49?

A. Exhibit (49)-49 shows net railway assets of $1,066,650,000; approximately 6 2/3% on this billion dollars of book value of railway assets, as shown by the balance sheet in Exhibit (49)-49."

A. May I interrupt there? There was an error in the record there. That should read:-

"Exhibit (49)-49 shows the net railway assets of approximately $1 billion and $66,650,000 is approximately 6 2/3% on this billion dollars of book value."

Q. That probably is right, $1.1 billion, and at the

same time as you will remember, at the hearing in the 20 Percent Case, we rejected Exhibit (49)-49 for a rate base the same way we do now, but you are assuming it here as a proper basis?

A. That is right.

Q. The $1,100,000,000 which we opposed and which the Board of Transport Commissioners did not accept as a rate base. You know that they did not accept it?

A. Yes. They said there would have to be further study.

Q. But, here is the important question:-

"What have you to say as to whether these are minimum or maximum figures?

A. These figures are, in my opinion, the minimum of the wages which would be necessary to attract new capital into the enterprise. As I stated, even these figures would not today attract that capital in the case of the preference and ordinary shares. And some allowance has to be made also for the cost of financing. But we do have, in the Canadian Pacific, some marginal cushion in these Other Income figures to provide a cushion to help in arriving at a position where we can sell these ordinary shares on a 10% basis."

Then the next question:-

"Did your figure for the common stock take into consideration the market pressure to which you referred a few moments ago?

A. It did not in itself take into consideration the market pressure. I believe that

in order to attract capital into a rail venture, that risk capital -- as to any competition in risk capital in other businesses, has to give 10%, or such risk capital will not be available from the rail earnings in and of themselves."

Then you go on over on the next page:-

"But this effect of market pressure is partially offset -- or should be offset in the case of the Canadian Pacific -- by the fact that there is Other Income coming from other sources. So that, on a corporate basis, the earnings would be enough to provide a price higher than $25 if 10% can be earned from the railroad on the ordinary shares, and something else from the outside sources. Then the day when the stock will again sell at $25 is nearer."

That is to say, you were convinced then and I take it you are convinced now, that there has to be 10% produced from rail earnings and rail earnings alone apart from Other Income before the stock can reach $25, and then it would have to remain at that for a few years, probably, before you could dispose of any common stock?

THE CHAIRMAN: We will take a few minutes recess.

....RECESS .

(Page 20537 follows)

answer on the same page 2578 that Mr. MacPherson read from.

THE WITNESS: Furthermore, may I ask this: You say, have I changed my opinion at all? Well, I gave my opinion then a year ago as to what the situation was then, and it is possible that that figure of 10 per cent today might be reduced to 9 per cent; that would make a difference in these figures of $4,650,000. $4,650,000 subtracted from the $66,600,000 would give a figure of $62 million in comparison with the figure that I agreed with you that might be considered within the realm of reason of $63 million a few minutes ago.

MR. MacPHERSON: Q. Now, Mr. Northey Jones, will you come back to the question and see if you can answer it, or, if you feel you want to answer it, the question that I asked you in the first place?

A. Whether my opinion was the same now as it was then?

Q. Yes.

A. I would say that my opinion was subject to some adjustment because of the change in market conditions now.

Q. And that is the only change you would give in the opinion you gave a year and a quarter ago and that I read into the record?

A. You get me tied down to the only change --

Q. Well, I mean you qualify it as you will; you are the witness.

A. I would say that I would think that for the Canadian Pacific -- I mean, this is subject again to the conditions that would exist as to the other income. Certainly if the other income were to take a terrific spurt, then the stock would sell at $25 more quickly. I think possibly some of this existing increase in the

price of Canadian Pacific stock is due to the idea that people have that there is oil in some of those acres out there.

Q. I would not be surprised. Now, just on that $1.1 billion, in your submission here today you figure on a basis of $1.1 billion?

A. I have used approximately a billion here.

Q. Approximately a billion?

A. That is right.

Q. And you do that because of this exhibit 49-49?

A. That is correct.

Q. That is right. And you know the objection that was taken by the provinces to that being the base?

A. I knew that they did take objection.

Q. Are you familiar with this? Are you familiar with the case Ex Parte 162, Mr. Northey Jones?

A. Well, I am cognizant of the case and some of the -- I have not read the whole record in the case.

Q. Well, I will read this and see if you remember this as being part of the decision from the Interstate Commerce Commission. This is from Ex Parte 162, at page 723 -- it is not the report that I have it from; I will give you the citation; I have not got it here. This is the Interstate Commerce Commission:

> "As we said in St. Paul and Puget Sound Accounts, 29 I.C.C. 508-509, 'All students of railroad economics are well aware of the fact that prior to 1907, when the Commission was given real power to control such matters, the accounts of carriers in many cases were influenced more by other considerations than by a desire to reflect the actual facts.' And in our Annual Report to Congress for 1908 we refer to 'the well-known

fact that no court, no commission or accountant or financial writer would for a moment consider that the present balance sheet statement purporting to give the cost of property suggests even in a remote degree a reliable measure either of the money invested or of present value.' Since adoption and use of the prescribed uniform system of accounts the force of these criticisms has been lessened, particularly as to property acquired or constructed after 1907, but as to the older portions of the railroad the criticism remains valid to a considerable degree."

THE CHAIRMAN: I am just wondering where we are getting to, Mr. MacPherson. You seem to be going over some things that were done before the Board.

MR MACPHERSON: Well, I am leaving that right now. This witness, my lord, has taken is 6 2/3 on the basis of the $1.1 billion.

THE CHAIRMAN: Yes, but, after all, is not the gist of that paragraph to this effect, that on the basis that the Board thought was a proper figure for requirements, $ 47,500,000 , certain rates were set? Now, he says, if the Canadian Pacific is to remain the standard on even that mode which the Board adopted or pursued, if in addition to that you recapitalize the C.N.R. the way it requests to be recapitalized, it will come out with such large surplus earnings that that will imperil the position of the C.P.R. That is your case, isn't it?

THE WITNESS: That is it, my lord.

MR MACPHERSON: That is the submission.

THE CHAIRMAN: Is not the case within narrower limits than those you are pursuing just now?

MR MACPHERSON: I am only saying this, my lord, in this connection, that he has taken that billion, in order to get his return on it he has taken that billion, and I am seeking to show in so far as the company is concerned that that in itself is too high an amount, and that the balance sheet of the company does not give a proper base by itself.

THE CHAIRMAN: Now, let us see. The immediate issue is this: The Canadian National is asking us to approve of a scheme for its recapitalization.

MR MACPHERSON: That is right.

THE CHAIRMAN: The Canadian Pacific is showing reasons why if that scheme is adopted the way it is now, it

would be harmful to the interests of the Canadian Pacific. Now, what is your attitude as between those two corporations? Are you in favour of the Canadian National---

MR MACPHERSON: Well, as a matter of fact, the next point that I am going to make is to find out how it will affect the freight payer. It is the freight payer I am concerned with.

THE CHAIRMAN: You mean how the proposed recapitalization of the Canadian National will affect the shipper; is that your idea?

MR MACPHERSON: No, not at the moment.

THE CHAIRMAN: That is the question, though.

MR MACPHERSON: But there is another question involved too. There is that involved, my lord, but there is also this involved from the witness's evidence, that the Canadian Pacific should have, to be, as he calls it, a strong, healthy and dynamic transportation agency, a return of $63 million, to have earnings of $63 million. Now, what I propose to do now, having finished the other angle of it what I propose to do now, is to see how that is going to affect the freight payer.

THE CHAIRMAN: Just let me see a moment. In what connection did you make that statement in this brief, Mr. Northey Jones?

MR MACPHERSON: At page 18.

THE CHAIRMAN: When you used those words, which I remember. Is that at page 18 ? Where are those words? I remember hearing them.

MR MACPHERSON: The second paragraph, my lord.

COMMISSIONER INNIS: What were the words?

MR MACPHERSON: "If the Canadian Pacific is to remain the standard in rate matters, and rates are set so that the Canadian Pacific could earn after income

tax an amount somewhere between the $47,500,000 requirement"---

THE CHAIRMAN: Yes, we know that.

MR MACPHERSON: "And the $66,600,000"---

THE CHAIRMAN: But the words "dynamic" and so on, where are they? You see, this paragraph is quite legitimate; it is an endeavour to show how the granting of what the C.N.R. is asking for would prejudicially affect the Canadian Pacific.

THE WITNESS: My lord, I think possibly at the bottom of page 16 and the top of---

THE CHAIRMAN: Pardon me. At this stage of our inquiry we are not trying to build up a case for the Canadian National.

MR MACPHERSON: No, but, my lord, the witness said before that there had to be, according to his evidence, $66,650,000 of rail earnings. Today he says that he put that figure at $63 million before the Canadian Pacific could be, as he puts it, a strong, healthy and dynamic transportation agency.

THE CHAIRMAN: What I want to know is how that concerns us now, at this stage. I am told this is on page 16.

MR O'DONNELL: The bottom paragraph, my lord, on page 16.

THE CHAIRMAN: Yes, it is on page 16:

"At this point let me reiterate that if the people of Canada are to have a strong, healthy and dynamic C.P.R. the earnings of the C.P.R. must be such that not only the operating costs of business are covered but also the costs or wages of capital must be covered."

Well, if that is just leading on to showing how it would be harmed by what the Canadian National is asking, all right;

but if it is just a supplement to the case for the C.P.R. which we have already heard, then it is not in its place here. I think you are extending it to that.

MR MACPHERSON: Well, I am extending it, very frankly, to this---

THE CHAIRMAN: Perhaps Mr. Carson would clear it up.

MR CARSON: That earlier part of Mr. Northey Jones' statement was leading to the all-important conclusion that is expressed in the latter part of the sentence on page 18, that is to say:

> "If the Canadian Pacific is to remain the standard in rate matters, and rates are set so that the Canadian Pacific could earn after income tax an amount somewhere between the $47,500,000 . . . and the $66,600,000, . . ."

Then the important words are these:

> "it seems reasonable to suppose that the Canadian National, with its larger system and greater gross revenues, should earn at least $50,000,000 a year before income tax."

And then he goes on to point out what would happen if they had earnings of that amount.

MR MACPHERSON: Well, my lord, it still goes back to 16---

THE CHAIRMAN: Yes, but, remember, we are now trying to find out what valid objections can be taken to the C.N.R.'s application. The Canadian Pacific says, "Well, it will hurt us," but we are not concerned now in going altogether into the Canadian Pacific's case over again and seeing what they should get or should not get; we have not time for that.

MR MACPHERSON: I am in the hands of the Commission, my lord.

THE CHAIRMAN: I mean to say, unless you can show us why we should.

MR MACPHERSON: Well, the witness was called, and I asked him the very first questions I asked him. First of all I asked him if he was not called for the purpose of giving evidence in connection with the recapitalization, and then giving evidence secondly---

THE CHAIRMAN: Of the C.N.R.

MR MACPHERSON: Of the C.N.R.; and then giving evidence secondly to show what by way of rail earnings were necessary for the Canadian Pacific to be the type of transportation agency that he described, and he said Yes, and it is on that phase of it I am cross-examining.

THE CHAIRMAN: I think that description is only incidental, because it is not really part of the case here. We would like now to know what objections there are to the application made by the Canadian National for the reconstruction of its capitalization.

MR MACPHERSON: All that I would like to show from the witness---

THE CHAIRMAN: Do you think that your questions, those that you are now directing to Mr. Northey Jones, are helping? Perhaps they are, but I would like to know just how they are.

MR MACPHERSON: Well, they would in this way, I think, my lord: So far as we are concerned, we are interested from the standpoint of the freight payer.

THE CHAIRMAN: Yes, I understand that.

MR MACPHERSON: And if, as he says, there has to be a return by way of railway earnings of $63 million, then what is that going to mean by additional imposition in freight rates? I mean, possibly from what he has said already we can work it out in argument, but I thought that

probably here would be a place where it could be put in.

THE CHAIRMAN: That is what does occur to me, Mr. MacPherson.

MR MACPHERSON: Well, we might be able to do that.

THE CHAIRMAN: You already have, I think, plenty of material for your argument.

MR MACPHERSON: We have too much, I am afraid, my lord; that is the only trouble. Well, there is this question that I think probably Ican put to him, in any event, my lord, that may be of some assistance to the Commission:

Q. At page 18 you take the requirements from the judgment of February 1950 at $47,500,000?

A. Yes.

Q. Now, when you deduct from that the fixed charges of $11,718,579, as they appear on page 7 of the judgment of March 1st , and $3,872,768 dividends for preferred stock, according to the annual report for 1949 at page 7, I suggest that the rail earnings for 1949 are $31,908,000?

MR CARSON: You are not saying it was that in 1949?

MR MACPHERSON: I am taking it from the last judgment.

THE WITNESS: This shows that the $47,500,000 of requirement of the Board is made up of $11,700,000 for fixed charges, dividends of $20,600,000, an allowance for surplus of $15,200,000, that allowance for surplus being for additions and betterments, and for a sum to go and come on in the Canadian Pacific situation, and those are the requirements. Now, Mr. MacPherson, I understood you to ask the question of me, is that the amount that was earned in 1949, or did the 1949 earnings -- were they equivalent to that from rail earnings? No, they were not.

MR MACPHERSON: Q. T hey were not equivalent to

that?

A. No.

Q. They were short by how much?

A. I would have to get that computation; I hesitate to give it. They were short so that there was no money available for the payment of the common dividend from rail earnings.

MR MACPHERSON: I think probably on this, to save time, I will try to deal with it in argument, but I---

THE CHAIRMAN: You see, Mr. MacPherson, I agree with you in this respect, that it may very well be that this brief travels beyond what it is really intended to do.

MR MACPHERSON: Well, it does that, my lord.

THE CHAIRMAN: Instead of being confined to meeting the case.

MR MACPHERSON: It does more than that.

MR CARSON: I do not want to get into that phase of the argument either at this stage. That entire statement of Mr. Northey Jones is directed to the one thing.

THE CHAIRMAN: The prior statement, you say?

MR CARSON: The entire statement he has read is directed to the one thing.

THE CHAIRMAN: Well, as long as it bears on the one thing; I am not prepared to say right now---

MR MACPHERSON: It goes further than that. It not only does that, my lord, but it seeks to establish what so far as the Canadian Pacific is concerned is the rail earnings it must receive, and it is to answer that phase of it that I have been cross-examining him. I am quite content with---

THE CHAIRMAN: What he says is this: He says, Here, now, whether the figures adopted by the Board are to be followed in the future, I mean the principle is there, or whether what he thinks are the right principles to follow,

which would make necessary a larger revenue, he says in any case all that will be interfered with by the recapitalization asked for by the Canadian National, because it would give it all the more surplus. Now, that is all it is; whichever is adopted---

MR MACPHERSON: He goes further in his submission, my lord, and says this, that whether---

THE CHAIRMAN: Pardon me a moment. Now, in so far as what the Canadian Pacific Railway wants to safeguard itself is concerned, I think it is contained in that amendment we saw the other day that Mr. Evans submitted. Isn't that so?

MR EVANS: Oh, yes, my lord. That is one suggestion we have made, and we also have said to you, sir, that some means should be found -- that was one suggestion we made. I am going to make other suggestions in argument that do not necessarily require specific legislation.

THE CHAIRMAN: Well, that may be, but this is not the time for that. You are talking now of when you come to argue before us, I suppose.

MR EVANS: Yes, sir; I would be glad to do it at any time.

MR MACPHERSON: My point is---

THE CHAIRMAN: What we are anxious to find out now are reasons which militate against granting the Canadian National Railways the relief they ask for.

MR MACPHERSON: Well, my lord, if that is so, all right, but so far as the evidence of the witness goes to showing that the Canadian Pacific is to have so much money for the purpose of being a live organization, whether the Canadian National is recapitalized or not---

THE CHAIRMAN: Well, I don't know about that. You see, he has an "or" there. He says, whether you take the

figures of so much or a return and so on, in either case he says they will suffer by the fact that the Canadian National will be having these large surplus earnings.

MR MACPHERSON: Yes, but he goes on---

THE CHAIRMAN: Now, what you are trying to do is to show that the Canadian P cific ought not to be---

MR MACPHERSON: What I am trying to show at the moment is that the Canadian Pacific with the $47,500,000 is earning a reasonable return; but, however, as your lordship suggests, probably it can be dealt with in argument, and I will leave the matter at that.

THE CHAIRMAN: I do not want to cut you off. If you think you must have this evidence from Mr. Northey Jones, ask him.

MR MACPHERSON: I think I can compute it, probably; I think I can do that.

THE CHAIRMAN: I think you can too.

MR MACPHERSON: But what I wanted to bring out in evidence from him, since he has given evidence to this effect, was that, whether there was recapitalization of the Canadian National or not, he says there has to be this earning power from rail in the Canadian Pacific, and I am suggesting if there is that earning power which he suggests of $63 million, then that is going to mean a further increase in freight rates, and I am suggesting his evidence goes to show that, whether the Canadian National is reorganized or not, in order to attract new capital which they will need, so-and-so must be done, and in the doing of that freight rates must be raised again.

THE CHAIRMAN: What you mean to say, then, is, this case of the C.N.R. is being turned by the C.P.R. into an attempt to make a new case for itself.

MR MACPHERSON: To strengthen their case.

THE CHAIRMAN: What about that, Mr. Evans?

MR EVANS: If I may put it so, that is an absurd position for Mr. MacPherson to take.

MR MACPHERSON: I submit not.

MR EVANS: On a number of occasions we have said we do not ask this Commission either for a freight rate increase or for the fixing of rate base or for fixing of its earning power based on that rate base. We have put in evidence of this kind for this purpose alone. Now, my friend Mr. MacPherson knows perfectly well we are not asking this Commission for a rate increase. We will have to go to the Board; we will have to establish with the Board what our earning power should be, and we do not ask this Commission to make that finding.

THE CHAIRMAN: That does occur to me. Now, can I take it this way, that if the Canadian National had not put their case before us for recapitalization---

MR EVANS: Mr. Jones would not have been called.

THE CHAIRMAN: Mr. Jones would not be here at all.

(Page 20552 follows)

MR. MacPHERSON: That is all right, my lord, so far as the evidence is concerned. The evidence of the witness has been directed to indicate what is required by the Canadian Pacific Railway apart from the Canadian National altogether, in order that it may attract fresh capital that it needs. Now, that was the point that has been urged as well as the other point. I know as well as my friend Mr. Evans, that this Commission is not going to grant an increase in freight rates, but what I sought to put to the Board, and what I will put to the Board by way of argument on the evidence that we have adduced from the witness is the fact that to keep it alive and keep it in a position to get this capital, would mean a further increase in freight rates. Perhaps I may leave it there and proceed to one or two other questions in connection with the evidence of Mr. Jones.

THE CHAIRMAN: May I ask you at this stage, Mr. MacPherson -- if you can answer me, do so, and if you cannot, tell me so -- you talk about representing the shippers. Are you instructed one way or the other about this application of the Canadian National Railways whether it is to be approved or not approved?

MR. MacPHERSON: I would rather deal with that in argument, my lord. Both our friends would like to know how all the provinces feel.

MR. O'DONNELL: I did not ask anything.

MR. MacPHERSON: No, but Mr. Carson was indulging in a little laughter.

MR. CARSON: I just had a laugh at your answer.

MR. MacPHERSON: Q. In your evidence, Mr. Northey Jones, you refer to the financing of the railways during the depression years in the United States. That was by the Government?

A. Yes.

Q. Has there been any recent financing through the R.F.C. of railways in the United States?

THE CHAIRMAN: Through what?

A. By the R.F.C., my lord. No important financing, I would say. I don't like to make it an inclusive "no" because some railroad may have had some small amount of securities sold to the R.F.C., but the R.F.C. has gradually been disposing of its rail securities and has got now to the business of lending more money to the railroads.

MR. MacPHERSON: Q. There was no objection by the railways to applying to the R.F.C. for financial assistance?

A. There was a terrific objection.

Q. By the railways?

A. By the railways, because it usually meant -- well, I will tell you one very specific reason. They looked very carefully into the salaries of the people - -

Q. Is there anything wrong with that?

A. No; it resulted in a reduction of the salaries of some of the officers of the railways applying.

Q. Was there anything wrong with that?

A. Yes, in some cases there was, but that is aside from the main point. There were other points involved. One of the big points was that the R.F.C. in making these loans were making them at a period of low business and when the railway was in bad shape and they exacted very large amounts of collateral for making their loans. For instance, previously securities had been sold to the public, and say a $10 million bond issue was sold to the public. The railroad was in financial straits, and could not get any money anywhere else,

and it went to the R.F.C., and the R.F.C. says, "We will give you another $10 million if you will put up $30 million collateral." The $30 million of collateral was put up, the railroad went bankrupt anyway, and you have a re-organization plan where the insurance companies and the other holders of the $10 million of bonds publicly sold have a claim for one-quarter of the assets, and the R.F.C. has a claim for three-quarters of the assets, although they each only put up $10 million. Those are things which arise.

Q. In any event, there was a great deal of money advanced to the railways by the R.F.C.?

A. When you are on the point of going bankrupt, you will do almost anything to get money that is honest, and it certainly was perfectly honest and honourable to go to the R.F.C. for the money.

COMMISSIONER INNIS: Q. How much money did the R.F.C. lose over the period, have you any idea?

A. I wouldn't want to say that figure, Dr. Innis.

MR. MacPHERSON: Q. You used another phrase this morning; you said they might get more by a reduction of rates. What had you in mind there?

A. I think that gets a little beyond my ken, because I don't propose to be an expert on rate matters at all, but there has been testimony here, I believe, that you have certain agreed rates in Canada and certain competitive rates, and sometimes by reducing rates you are able to attract more business and so make more money. That is what I mean.

Q. What you had in mind was that more traffic volume would be obtained by reduction of rates in the proper case?

A. That is right.

COMMISSIONER INNIS: Q. What interest rates do they charge?

A. In the R.F.C.?

Q. Yes.

A. The general going rate in the 30's was 4%.

MR. MacPHERSON: Q. Were they long term or short term advances?

A. All kinds of terms. Mostly , I would say, intermediate terms, 10, 15 or 20 years. There were a lot of shorter terms ones, and there were equipment trusts that were serials that were bought.

Q. You referred this morning, I think, to Mr. Carson to the effect that the sales of common stock which had taken place in the United States and which had been filed in Exhibit 274 show the sales from 1930 on -- that is the letter of Mr. Boles -- all the sales from 1930 on had been practically family financing, so far as the - -

A. That is right, intercorporate.

Q. So, actually, according to your evidence there has been no genuine sale to the public of common stock in railways since 1930?

A. I would like to amend that. That statement by Mr. Boles, I think, said for new money purposes, if you will read his letter. There have been what are known as secondary offerings, that is, not a new issue of stock, but a sale of railroad stock. In the year 1945, you may recall a year and a quarter ago I said that the only large sale of common stock by a railroad in recent years in the United States had been the sale by the Atlantic Coast Line Railroad Company of some 370,000 shares of common stock of the Louisville and Nashville Railroad Company. The majority of the stock in the Louisville and Nashville Railroad Company had been owned by the Atlantic Coast Line, and the Atlantic Coast line, in order to obtain funds to redeem some of its debts sold 370,000 shares of its holdings of the L. & N. stock for about $21 million, so there was that which is a secondary sale, which produced no money for the L. & N. Railroad but produced it for the owner of the stock, the Atlantic Coast Line.

Q. In this letter of Mr. Boles, again, in respect to the Pennsylvania issue in 1930, there was $18 million issued?

A. Authorized.

Q. Authorized, but only $7,300,000 sold?

A. Yes; that was an offering to the officers and employees of the Pennsylvania Railroad and they subscribed for the $7,300,000 shown there.

Q. The Chesapeake and Ohio, that was the only one on the list where there was a complete sale of the amount authorized?

A. That is, complete sale to the investing public.

Q. And the Chesapeake and Ohio is one of the Pocohontas group of Raulways?

A. Yes, a soft coal carrier, and it has been a very good earner until this past year when they had trouble in the coal mines.

MR. MacPHERSON: I do not think, my lord, I will have anything more, but I may have a question or two in the morning.

---The Commission adjourned at 4:50 p.m. to meet again at 10:30 a.m. on Tuesday, April 25, 1950.

ROYAL COMMISSION
ON
TRANSPORTATION

EVIDENCE HEARD ON

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
TUESDAY
APRIL 25, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN

HAROLD ADAMS INNIS - COMMISSIONER

HENRY FORBES ANGUS - COMMISSIONER

G.R. Hunter
Secretary

P.L. Belcourt
Asst. Secretary

COUNSEL APPEARING:-

F.M. Covert, K.C. G.C. Desmarais, K.C.	Royal Commission on Transportation
H.E. O'Donnell, K.C. N.J. MacMillan H.C. Friel, K.C.	Canadian National Railways
C.F.H. Carson, K.C. F.C.S. Evans, K.C. K.D.M. Spence I.D. Sinclair	Canadian Pacific Railway
C.W. Brazier	Province of British Columbia
J.J. Frawley, K.C.	Province of Alberta
M.A. MacPherson, K.C.	Province of Saskatchewan
C.D. Shepard	Province of Manitoba
J. Paul Barry	Province of New Brunswick
Frank D. Smith, K.C.	Province of Nova Scotia

Ottawa, Ontario,
Tuesday, April 25, 1950.

MORNING SESSION

ALLEN NORTHEY JONES - Recalled

THE CHAIRMAN: Is there anybody else?

MR. MacPHERSON: There are no further questions from me, Mr. Chairman. Thank you very much, Mr. Northey Jones.

THE WITNESS: Thank you.

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CROSS-EXAMINATION BY MR. FRAWLEY

Q. Mr. Northey Jones, you agree in a general way that there must be some recapitalization of the Canadian National?

A. I would say so, yes, sir.

Q. And you, of course, have not applied your mind to that problem extensively enough to recommend perhaps just what should be done in detail?

A. That is correct, sir.

Q. The principal objective would appear to be that the fixed charges must come down?

A. As expressed in the Canadian National plan, yes.

Q. That is right, and their plan would bring the fixed charges down to something in the neighbourhood of $20 million?

A. Something in the neighbourhood of $15 million to $17 million.

Q. Yes, and there is not much doubt in your view that if they were rid of that burden they would earn some surpluses?

A. Well, that is forecasting the future, and that

is a very difficult thing to do because there are elements that come into that forecasting such as the level of business activity in Canada, the percentage of transportation service that will be performed by the railways, what the rates are going to be, what the costs are going to be, and my opinion would be that with a business such as the Canadian National, with the business that it is doing and might be expected to do in the future there would be a likelihood that there would be, and in fact there should be, as a return in my opinion on the investment in that vast enterprise a net return of some $15 million or $17 million a year.

Q. You see last year of course they had a net available for payment of interest of $4 million, but the two payments of interest to the public and to the government turned it into a deficit of $42 million?

A. Yes, sir.

Q. But you see in the future, as you have just said, some sufficient improvement that that net available for payment of interest or fixed charges should be something substantial?

A. Yes, sir.

Q. Now, I want to come back to the C.N.R. in a moment, but let us go for a moment to the Canadian Pacific. Speaking generally again your view is that the stock should go back to par?

A. I would think that the earnings on the enterprise ought to be such that the people who have invested money in that enterprise should have a fair return, and I would consider that a fair return meant that they should get a dividend, and that there should be some surplus left over for reinvestment in the property. I further stated, and this may be my main thesis as an investment banker, that it

would be necessary to raise capital in the future, and to attract capital in a competitive market for capital where railway capital is trying to be raised, where industrial capital, public utility capital are being raised, that people will not invest in the Canadian Pacific or a railroad enterprise unless the wages paid to the capital in that enterprise are commensurate with what are paid in other enterprises.

Q. It may be, Mr. Northey Jones, that the two ideas are separate. You do feel that the stock should go back to par, but that is to enable it to be readily disposed of?

A That is correct, sir.

Q. But you also think that the earnings on the common stock should be much more than they are now?

A. That is correct, because as it has been in the past four years the situation has been that there have been no railway earnings for dividends, and such dividends that have been paid have been paid out of other income rather than out of the railway enterprise as such.

Q. You think that the earnings on the common stock should go up to 10 per cent, the earnings should go to somewhere in the neighbourhood of 10 per cent?

A. I do, sir.

Q. But you did qualify that or did explain that you did not mean by that that the company should start paying dividends of 10 per cent?

A. No, not at all.

Q. You thought the dividends perhaps should remain where they are at 5 per cent and the remaining 5 per cent put into surplus?

A. That is correct, sir.

Q. Perhaps you would not just hold it at the 5 per cent. Perhaps you do envisage some improvement. If they earned 10 per cent they might be able to increase the dividend rate?

A. If they were able to earn 10 per cent on the common stock from the railway enterprise, and retained half of that for reinvestment in the property and paid a 5 per cent dividend out of railway earnings, it would leave room for an increase in dividends above the present dividend by payment out of non-railway or other income.

Q. Do you not see any possibility of paying more than 5 per cent if the rail enterprise earned 10 per cent? I wondered what you thought about that.

A. That is getting back to one of those old rule of thumb calculations that a great many companies have used, or their directors have used the rule of thumb -- not always strictly applicable -- that for every dollar they pay out in dividends to the stockholders they want to reinvest $1 in the enterprise.

Q. You would hold pretty well to the 5 per cent? You do not see even if they earned 10 per cent on the common stock that they should pay out any more than 5 per cent?

A. There is not only the question of reinvesting money in the enterprise. There is also the question of raising the dividend and not having as much to reinvest and also to come and go on, to take care of the swings. In other words, if they were to raise the dividend one year and the next year the earnings were to be down somewhat and they decreased the dividend, they would be better off in my opinion if they tried to maintain a stable dividend rather than raise it to a rate which was too close to the earnings without having some surplus to

reinvest and to take care of the swings in earnings, so that you might call it a dividend stabilization amount.

Q. Let us leave it at that. I think I see what you mean there. You do look though for an increase in the dollar earnings of the Canadian Pacific, and quite appreciably greater than they earned last year, for instance?

A. Yes. I think the recent decisions will give them larger earnings than they had last year.

Q. But as I understand you you think they should have greater dollar earnings. I think you said yesterday to Mr. MacPherson it perhaps should be about $63 million?

A. I did, sir.

Q. That, of course, would require an increase in freight rates?

A. I believe I pointed out in answer to Mr. MacPherson yesterday that there were several ways of arriving at an increase in net income, the several ways being rates, economies, increases in efficiency by doing things mechanically that used to be done by hand, mechanization, for instance, of the maintenance work. There are all kinds of machines now which help to save money, in addition to the diesel program which the company has.

Q. It may not be an unfair way to put it to say that to achieve this objective of a $63 million income some of it may be acquired by economies, by dieselization, but in the end to the extent that it was not received in that fashion then it would have to be made up by increased freight rates?

A. Yes, and growth in business.

THE CHAIRMAN: Q. And what?

A. And growth in the volume of business.

MR. FRAWLEY: Q. So even though the increase in freight rates was only contributing along with economies the freight shippers would be paying increased rates to enable the company to earn 10 per cent on its common and 5 per cent on its preference which perhaps it is earning now?

A. That is right.

Q. I do not want to over-simplify it, but perhaps one might say that increased freight rates then would have to enable the company to maintain a general level of 10 per cent on the common?

A. Approximately that, yes.

Q. Let us turn for a moment to what the Canadian National might afford to the freight shippers of Canada. If the fixed charges were cut down to between $15 million and $17 million, and without any income tax because in the nature of it there is no income tax payable, and no dividends, under the present plan anyway by virtue again of the nature of the enterprise it is not at all unreasonable to suppose if freight rates were to be fixed upon the basis of the needs of the Canadian National that they could indeed be substantially lower than rates fixed on the needs of the Canadian Pacific?

A. In my opinion if the need of the Canadian National was determined purely on the basis of meeting a fixed charge of from $15 million to $17 million with no requirement to pay any return on the equity capital held by the government, in that case it is conceivable in my mind that the freight rate that would support that might be set at a lower figure than would support the Canadian Pacific and allow it to live and earn and pay a return on its equity capital.

Q. Let us assume for the sake of this discussion that the rate base and rate of return has not yet come into it, that that may take some time to develop, and that we are still discussing it on the basis of requirement.

A. Right.

Q. I put it to you again if the Canadian National had its fixed charges cut down to a level of $17 million, let us say, and the rest of the plan accepted broadly as submitted, that there would be on the basis of their requirements a very good possibility that freight rates would be much lower?

(Page 20563 follows)

A. I would like to qualify that by saying that I think there would be a possibility that, based on that requirement, a lower freight rate could be set.

Q. Now, Mr. Northey Jones, the Canadian Pacific are, as far as you know, really alarmed about the possibilities of danger coming to them through the acceptance of the Canadian National plan as submitted?

A. As it is submitted, yes.

Q. There is no real question about that. They have asked you to come from New York to make this statement, they have a gentleman from Queen's University to follow you, and the Resident Manager of Price Waterhouse is to follow Mr. Elliott and to speak broadly along the lines you have spoken to express the alarm of the Canadian Pacific about this plan?

A. That is correct.

Q. Now, do you know whether the Canadian Pacific is willing to give some quid pro quo for the rejection of the Canadian National plan?

A. I am not in a position to speak for the Canadian Pacific on that point, but I would say this, that I had understood that right through these hearings the point of the Canadian Pacific was not the rejection of the plan in toto or against a recapitalization plan of the Canadian National, but against one unless they had protection.

Q. Then that protection, as I see it, seems to have come from various witnesses, but it always seems to come down to the same thing, that the Canadian National should pay over something -- it has been called a return, but let us look upon it as dividends; it means the same thing, and I can understand it a little bit better -- they would really be asked to pay over a dividend through the Minister of Finance each year as the Canadian Pacific sets aside

something for its shareholders by way of dividend to have a parity of some kind?

A. I think that has been the tenor of certain remarks that have been made here, and it also was a suggestion -- not that I should make suggestions, maybe, as to what you should do here, but a suggestion based on what reorganized railroads of the United States have done, in that they have provided that there be a certain amount of fixed charges, then a so-called capital fund which allows the railway to retain for reinvestment in the property and building additions and betterments a certain sum of money, and then after that a provision that some income bonds be issued and that the income bonds would pay in the form of contingent interest a sum to the owner of those income bonds; in this case if such a plan were to be follo' ", the Canadian National case, it would mean a payment of interest, contingent interest, to the Government if it were earned by the Canadian National.

Q. Now, that is, of course, you will agree, speaking generally now, that is not at all a cardinal -- it is rather the opposite, is it not, of the cardinal principle of the publicly-owned utility; the objective of a publicly-owned utility, speaking broadly, is service at cost, isn't it?

THE CHAIRMAN: Is what did you say?

MR FRAWLEY: Service at cost, without profit to the owners, the owners being the state.

THE WITNESS: I would not say that that was generally so, no, Mr. Frawley.

MR FRAWLEY: Q. In many instances it is so, isn't it?

A. I would say that in a great many instances these Government operations are called yardstick operations to test whether the private operation is being run at as low cost as possible.

Q. Well, take the province of---

A. And in figuring those costs on that Government operation, in order that the comparison might be fair, that some return or some wage on the money that was invested in the property has to be computed. Now, there is a difference usually in all cases, that the Government enterprise does not have to pay taxes, and as such its cost of doing service is that much less, because by being relieved of those taxes the other taxpayers have to pay more.

Q. Well, Mr. Northey Jones, don't you agree that when a state or a province like the Province of Ontario sets up its power development it is , doing that largely to supply that to the people of Ontario at cost, and not for the purpose of swelling provincial revenues? Isn't that so?

A. But the Hydro has a lot of securities outstanding with the public, and it must pay a return on that; if its credit is to be maintained it must pay a return on those securities.

Q. I know, but, Mr. Northey Jones, we have not got---

THE CHAIRMAN: Mr. Frawley, are you bearing in mind the difference between a municipal or Government enterprise which has a monopoly and one such as---

MR FRAWLEY: That distinction must always be borne in mind, sir. That is the problem here, there is no doubt about it. But I wanted to discuss it separately first. I thought that perhaps there would be agreement in general that when a province or a state sets out -- a province, speaking of Canada, because I do not know anything about the United States -- when a province such as the three western provinces sets out to own its own telephone system, they are doing that not for the purpose of making

money in ease of the taxpayer, but to provide telephone service for the people at cost or as near cost as possible? Isn't that, roughly speaking, about what the idea is?

A. That gets, Mr. Frawley, into what you define as cost today, and cost -- I presume this money may be raised by bond issues of the province. Now, if the cost does not include a charge to the operating utility to pay that interest cost, then the service in my opinion is being given to the people of the province at less than cost.

Q. Now, Mr. Northey Jones, let us get back to the Canadian National. The people of Canada have put vast sums into the Canadian National over a period of many years?

A. That is correct.

Q. And even on this plan of Mr. Gordon's it is probable that the people again must be asked to make substantial contributions, either by negativing certain indebtednesses or otherwise; that is true? The people of Canada are being asked to pay -- the taxpayers?

A. Well, they certainly have paid by providing for the deficits in the past. There again, you say in the future they are going to be asked to pay. I would think that in the future the set-up would try to be such that they would not have to pay.

Q. But as of now, as of now, the deficit they have paid annually, the vast sums in the past by way of guarantee for branch lines, the $300 million that is in this plan at the moment -- I understand that is still there, isn't it? All I mean to say is, the people of Canada may say, "Well, it is time that we got something out of this by way of cheaper freight rates." Isn't that conceivable, that public opinion in Canada or a large sec-

tion of it may just have that view?

A. I would say that certain people would have that view, and certain taxpayers would have tht other view, that the taxes should not be raised to pay for the Canadian National deficits.

Q. That is true. Now, suppose there was a large body of opinion which had to be met and faced and examined, which said, "Well, it is time now that we had the Canadian National serve as the yardstick for freight rates in Canada," and on the basis that I have briefly outlined here to you, and your statement to me, then there could be some amelioration of the freight rate situation; assume there was a large body of that public opinion; it is conceivable, isn't it?

A. There are a large number of shippers. I do not understand that in the preceding cases the shippers have come forward objecting strenuously to the increases in rates.

Q. I know, but surely, now, you are sufficiently broad-minded to agree with me that there may be some people in Canada today that are carrying a large burden of freight rates that think that this may be a solution?

A. Well, I might argue with you as to the large burden of freight rates, because there is a question there as to whether that is burdensome and as to their return from their industrial, commercial, agricultural, mining or other operations, whether that freight rate is a large burden or whether it has become a lesser proportional burden than their other costs.

COMMISSIONER ANGUS: Mr. Frawley, as you use the word "cost", is the interest which the Government of Canada has to pay to its bondholders on these vast sums

that you have mentioned, a cost or is it not a cost?

MR FRAWLEY: Well, I wonder, sir. It is money paid out, I suppose, every year.

COMMISSIONER ANGUS: When you are examining the witness it seems to me there is a certain ambiguity there, as to services at cost or services at less than cost, and so on. Is there a cost there, as you have been using the word in the last five minutes?

MR FRAWLEY: Well, I certainly meant that it was a dollar payment and a dollar drain on the taxpayer of Canada to pay out, even the $300 million that Mr. Gordon wants in this plan, and there has been a dollar drain on the taxpayer for the interest paid in guarantee of branch lines.

Q. It has cost the people of Canada money, at least, hasn't it?

A. That is so.

Q. Moneys have been paid, many dollars have been paid out?

A. That is right.

COMMISSIONER ANGUS: Is that part of the cost of the Canadian National Railways , as you use the word?

MR FRAWLEY: Well, it may be part of the so-called property investment in the Canadian National Railways, that is true.

THE WITNESS: Well, we get into a little difficulty there, Mr. Frawley, don't we, when we look at a question of whether a cost is a capital cost in which there is a real asset and a real investment, or whether we have an annual operating cost which has to be met. There are two items; that is, there are capital costs or capital investments which have to be made, and there are also the operating costs from year to year that have to be met.

MR FRAWLEY: Q. Let me put it this way, perhaps. I do not know whether this is too narrow an example or not, but here is a shipper or a receiver of freight in Alberta who has to pay $2.58 to bring 100 pounds of canned goods from Eastern Canada to Edmonton or Calgary. Let us assume that man. Now, at the end of the year he has to pay something else in his income tax for the deficits of the Canadian National Railway. That is a fair statement?

A. That is true, yes.

Q. Now let us suppose that man, and perhaps hundreds of thousands like him, say, "Well, now is the time to stop, now is the time to take the Canadian National, rehabilitated in the fashion Mr. Gordon suggests, and, if you please, make them the yardstick for Canadian freight rates from now on." All I am putting to you is that there may very well be a body of that opinion?

A. I would think so. As a matter of fact, I said I believe that if there were substantial surpluses in the Canadian National based on this low fixed charge requirement of $15 to $17 million, I thought that there would be interests that would ask that the Canadian National be made the yardstick.

Q. All right. Now let me come to the point---

THE CHAIRMAN: Isn't that the very thing that the Canadian Pacific Railway is afraid of?

MR FRAWLEY: Yes, my lord.

THE CHAIRMAN: The thing that you are conjuring up is a natural consequence.

MR FRAWLEY: Now, my lord, my next question will indicate the point of my cross-examination.

COMMISSIONER ANGUS: Before you come to that, Mr. Frawley, I am afraid I must try to get a more specific answer to my question. When you said that a public utility

aims at giving service at cost, do you include in the cost the capital cost of acquiring the public utility?

MR FRAWLEY: Well, I would think so, sir. Take something that I know just a little bit about, the Alberta Government Telephones. The rates on the Alberta Government Telephones are not fixed to supply revenues for the Government of Alberta, revenues for the Provincial Treasurer, at the end of the year, like the liquor business, for instance. That, very roughly, is my point, sir. They are not seeking a profit out of selling telephone service to the people of Alberta.

COMMISSIONER ANGUS: Are they seeking to get from the people who use the telephones the money which they will have to pay in interest on the bonds that they have issued in order to acquire the telephones?

MR FRAWLEY: Oh, yes, sir, if they have issued bonds they must service all their debt and so on; but over and above that, sir, they pay no dividends to the Provincial Treasurer of Alberta, nor are they supposed to. Now, whether it is a point or not, sir, that is all I am seeking to---

COMMISSIONER ANGUS: To take another example, the British railways recently acquired; the rates are to be fixed, I think, so as to enable them to pay interest on the cost of acquiring the railways, plus I think a fund for amortizing it.

MR FRAWLEY: I saw something like that in Mr. Norman's statement. I think that point is dealt with there, sir.

Q. Now, Mr. Northey Jones, suppose that this Commission and that the majority of the public opinion in Canada has quite the contrary view to the one that I just put to you, and they said, "No, that must not be. The Canadian Pacific must not be put to the wall, with all the consequences," and

suppose that I am now putting it to you on that basis, that that situation cannot be allowed?

A. Right.

Q. Now, I put it to you again, what is the Canadian Pacific Railway Company willing to do about that, do you know?

A. Well, I presume that the Canadian Pacific is going to go ahead and furnish a splendid form of transportation service, steadily increasing the availability of service, the speed of service, the convenience of service. I am talking about freight service now---

Q. Yes, but, Mr. Northey Jones---

MR CARSON: Let him finish.

MR FRAWLEY: Q. If you have something to finish, yes.

(Page 20572 follows)

A. And that it will furnish that transportation so that over the years that it will increase its efficiencies and its economies so that, depending on price levels, rates which might otherwise have to go up would either not have to go up or not go up as much because of giving a more efficient transportation service. For that reason therefore, I say it is in the interests of the people of Canada, to get that more efficient service, that the Canadian Pacific be in a position that it can raise the capital necessary to make those improvements which will make the economies which will be a factor against the increasing of rates.

Q. Yes, I know. But those objectives they have had for some time. Those are the same objectives they had when you were here a year and a quarter ago.

A. That is correct.

Q. What you have not stated is pretty well what you told us at that time.

A. That is correct.

Q. I am putting to you a different matter. The Canadian National has a new capital plan which is very alarming to the Canadian Pacific. It has possibilities of visiting disaster upon the Canadian Pacific. Suppose this Commission rejects it. What is the Canadian Pacific Railway willing to pay for being rid of this impending disaster? That is my point.

A. I do not think that they should have to pay anything to be rid of something that is unfair to them.

Q. That is all I want to know. You say that the situation is just the same as if there had never been the Gordon plan at all?

A. That is correct.

Q. That is your definite opinion?

A. Yes.

Q. So there is a question about getting any good to the Canadian people out of rehabilitating the Canadian National, either directly or indirectly?

A. Wait a minute. You asked me about the effect on the Canadian Pacific which is really what I am here to speak about.

Q. Yes.

A. Now you jump over and say that there is no good at all to the Canadian people from recapitalization of the Canadian National. That jump I would not take, no. I think there is some good to be obtained. I think that it is reasonable that the Canadian National should have a recapitalization plan.

Q. With respect, may I say that it is not my point now. You have agreed with me as to what good might come from making the Canadian National the yardstick in the way of lower freight rates.

A. Yes. I do not consider that a good, necessarily.

Q. You have said that it might very well result in some amelioration of the freight rates?

A. No; some lowering of the freight rates, not amelioration of the freight rates.

Q. All right, some lowering of the freight rates. Assume with me that we will not have that, that there are over-powering reasons why the Canadian Pacific must be kept, as it is, the yardstick for the Canadian freight rate structure. I ask you to assume that now. All I am saying to you is this. Must there be no change whatever? Must it still have its $66 million or $63 million? Do you not envisage any more stringent regulation of the

Canadian Pacific in the view of the Canadian people because we have abandoned the Canadian National as a yardstick?

MR. CARSON: I wonder if the reporter will read back that question so that we can see how many questions the witness is expected to answer, or perhaps Mr. Frawley will re-state his question.

THE CHAIRMAN: The question is a bit long, but I think in the result in is not too obtuse.

MR. FRAWLEY: Not for Mr. Northey Jones; not for a moment. It is more important that Mr. Northey Jones should answer it.

MR. CARSON: Q. You understand that question, do you, Mr. Northey Jones?

A. May I phrase it in my own words?

MR. FRAWLEY: Q. Yes. You probably would anyway.

A. Are the Canadian Pacific to be penalized if this Commission is to turn down this request of the C.N.R. - -

Q. I did not say "penalized". Is there any change at all? That is my point. I cannot put it in any simpler form than that. Is there any change at all in the situation since the submission of the Canadian National's proposal than there was before or must the Canadian Pacific be looked at in the same fashion, as the yardstick, as before?

A. I would say that the Canadian Pacific should be looked at in the same fashion in that it should receive a fair return.

Q. You think that if the freight shippers of Alberta, for instance, represented by me, are willing

to say yes, the Canadian Pacific must be the yardstick because, after all, we believe in free enterprise and we do not want the Canadian Pacific to be put to the wall, because it has been a great institution in this country. Suppose the people of Alberta said that?

A. I hope they will.

Q. All right. Just assume now that that is what they will say. Perhaps you can do a little bit of reading between the lines; I do not know. But assume that is what they will say. Do you say at the same time that they have no right to say to this Commission, "We are willing to give up the Canadian National as the yardstick, with the hope that if we do, we would get service at cost," using that term broadly, and that they must just go along looking after the C.P.R. in the same tidy fashion as they have looked after it up to now? That is my question. What do you say?

A. I am afraid I cannot give a direct answer to that question. In the first place, I cannot speak for the Canadian Pacific on a question like that. It just comes down, it seems to me, to this. whether what you are asking is a quid pro quo for something, when all the Canadian Pacific is asking here, and has asked for, in my opinion, is that they be allowed to earn a fair return or earn their requirements.

Q. That is right; and that those requirements must be their requirements as we see them now in their Annual Report?

A. Yes; that there should be no recapitalization.

Q. No change in fixed charges?

A. No change in fixed charges.

Q. The dividend must go on at 5%?

A. I would say that was a modest dividend.

Q. You see nothing incumbent upon the Canadian Pacific if they have been saved from this impending disaster, that they should look into - -

MR. CARSON: Oh, oh.

MR. FRAWLEY: My friend laughs. I am very serious about it whether my friend is or not. Here is the Canadian Pacific coming in and speaking about this disaster. If the people of Canada are willing to see that this disaster does not take place, does the Canadian Pacific Railway make no quid pro quo?

THE CHAIRMAN: You are putting your questions on that foundation, and they are all right.

MR. FRAWLEY: Q. Have you a copy of the Annual Report there, Mr. Northey Jones?

A. Of the Canadian Pacific?

Q. Yes.

A. Yes.

Q. Will you look at the fixed charges there?

MR. O'DONNELL: Is that Exhibit 268?

MR. FRAWLEY: Yes, Exhibit 268.

Q. Are you aware of the fact that one of the items in the fixed charges - and you can look at it; it is at page 32 -- that there is appearing annually on account of the Ontario and Quebec Railway is one of over $900,000. It is down a little because of the favourable exchange situation; it used to be over $1 million. That is because of an ancient Statute and Agreement which requires payment at 6% in perpetuity. Would you think that that perhaps is one of the quid pro quos that a fixed charge like that

should be renegotiated, even if the Statute has to be amended.

A. I would think if there is a contractual right that the holders of these securities of the Ontario and Quebec Railway should receive a certain amount of money, the contractual right of those holders should not be abrogated by a statute of Canada.

Q. We get nothing out of that, then. The fixed charges stay as they are. That is one requirement. That is not changed as a result of the people of Canada permitting the Canadian Pacific to go along as the yard-stick. That is one change that is not made.

A. That is right.

Q. And the dividend is 5 per cent. That is another change that is not made.

A. I would say that that should not be made.

Q. They must have the surplus that they ask for?

A. I would say that --

Q. And it is $15.2 million.. It might be $17 million or $18 million next time. They are to get all that they ask for?

MR. CARSON: That they ask for?

MR. FRAWLEY: That is my question, that they ask for.

THE WITNESS: I believe they should receive more than they have asked for.

RR. FRAWLEY: That is even better.

COMMISSIONER ANGUS: Q. Mr. Northey Jones, you have, I think, put the retained income from rail earnings for the Canadian Pacific - by implication at least - as high as about

$23 million, have you not? I am calculating that in this way. Ten per cent on the ordinary stock would be $46,500,000, and you say 5 per cent might be paid out. That would leave retained earnings of half that.

A. Yes. I might say, in answer to that, Dr. Angus, that that capital structure on which those returns were figured and which I presented in the evidence a year and a quarter ago is not the existing capital structure of the Canadian Pacific Railway but was a theoretical capital structure which I proposed as a goal which the Canadian Pacific might hope to attain in the future, of having one third debt, one sixth preference stock and one half common stock. Actually the situation is different from that here in that there is a greater percentage of debt.

Q. If they obtained that theoretical capitalization, I gather that you would consider retained income from rail earnings of $23,500,000 --

A. That is correct.

Q. -- as appropriate?

A. As appropriate, as compared with that $15 million in the present requirement.

Q. And would you consider a surplus of a corresponding size as reasonable for the C.N.R. to retain before paying anything to the government?

A I would think that a surplus of somewhere between 3 and 4 or 4½ per cent of the gross revenues -- I think I stated yesterday that in our reorganizations in the United States these amounts of gross revenues that may be retained for so-called capital funds vary between 1½ per cent and 4½ per cent. I suggested possibly 3 per cent or $15 for the C.N.R., which is the $15 million. I think on their system that it would be conceivable that the amount might

be more than $15 million for the C.N.R. I think that is a matter of negotiation, after the Canadian National has shown figures that it would be able to show, what amount would be reasonable as a capital fund . It would be somewhere in that neighbourhood, $15 million to $23 million.

MR. FRAWLEY: Q. Then, Mr. NortheyJones, to sum up your evidence, you are of the same view that you had with regard to the needs and requirements of the Canadian Pacific as you were when you came here a year and a quarter ago. There has been no change whatever as a result of the submission of the Canadian National Railways?

A. Not as a result of the submission of the Canadian National Railway. I think in talking or in answering Mr. MacPherson yesterday, when he pressed me -- not unduly, I do not mean -- that there was no change at all, I said that there was some change in markets today, and that --

THE CHAIRMAN: Q. Some change in what?

A. Some change in markets; security markets.

Q. Yes?

A. And that perhaps the figure of $66 million which I had mentioned a year and a quarter ago was susceptible to some change on the basis that the figure I had given there was the amount necessary to attract new capital and that therefore it might be reduced to a figure of say $63 million.

MR. FRAWLEY: Q. Yes. By and large there is no change in your position,dollar-wise, as to the Canadian Pacific Railway?

A. Not significant, no.

Q. No.

A. Not that I want to say that $3 million is not significant. Do not get me wrong about that.

Q. So that if there are now people in Canada who have become enlightened to the point where they may see the possibility of having the whole freight rate structure lowered

by making the Canadian National the yardstick and they are willing to give that up because private enterprise must be kept up, you say that they get nothing for that; they are just in the same position as they were before; they just go on paying the Canadian Pacific's freight rates?

A. I did not say, Mr. Frawley, that they were in just the same position they were in before. But I said that as far as the Canadian Pacific was concerned I thought that they were in the same position as far as the Canadian Pacific was concerned in that they should still be entitled to earn a fair return.

(Page 20583 follows)

Q. That is what I mean. As far as you are able to interpret from your conferences with high executives of the Canadian Pacific that is how they feel about it, that they must be just allowed to go on precisely as they are, and that this plan of the Canadian National must be just brushed aside?

A. I hate to repeat myself but I think I must because I would not want the inference to be that the Canadian National proposal should be just brushed aside. I do not believe the Canadian Pacific has ever said, at least from my reading of the testimony here, that it should be just brushed aside. I think they have been sympathetic with it, and that they have said that they have no desire that the Canadian National should not be recapitalized provided they are protected.

Q. But the factual position that the Canadian National pays no income tax and the factual position that the Canadian National pays no dividends must not be allowed to determine freight rates in Canada?

A. No, they maintain they must have --

Q. That must continue?

A. They maintain they must have a fair return.

Q And that has been the continuing position of the Canadian Pacific, that the Canadian National's better factual position, once this absurd capitalization is reduced, must have nothing at all to do with the determination of freight rates in Canada?

A. As far as the Canadian Pacific is concerned they must have a fair return.

Q. And if there is any body of public opinion that voices any such feelings they must just change their mind?

THE CHAIRMAN: What feeling, that they should not have a fair return?

MR. FRAWLEY: That the Canadian National could be made the yardstick for the fixing of rates..

THE CHAIRMAN: Regardless of the consequences to the Canadian Pacific?

MR. FRAWLEY: That is true.

Q. And if they are willing to abandon that view and go along with the idea that the Canadian Pacific must be kept as the yardstick you see no place at all for any amelioration of the freight rate burden?

A. Not other than I have expressed before.

MR. FRAWLEY: Thank you very much.

COMMISSIONER INNIS: Would it not be fair to say, Mr. Frawley, that you are trying to determine the extent of this protection, the solidity of the protection and then how much the Canadian Pacific is willing to pay for it?

MR. FRAWLEY: That is right; that is exactly right. That is what I am trying to determine through the mouth of this witness, and I am now faced with the fact that we are just at the same place we were before the Canadian National made the proposal so far as the witness is concerned.

COMMISSIONER ANGUS: Would that not come very close to depicting the Canadian taxpayer as a sort of Hitler, in other words, what will you give me not to give you a kick in the pants?

MR. FRAWLEY: Except I think there are a lot of people, and particularly out in the country where the freight rates are paid and paid heavily, to whom it probably seems too bad that the railway which we own cannot be the railway which determines the rates we pay.

THE CHAIRMAN: While you are on that point, I notice that among the dire consequences which the C.P.R.

foresees is the one that all railways may become government railways.

MR. FRAWLEY: Yes, my lord.

THE CHAIRMAN: They say there is a possibility that the C.P.R. might have to be taken over by the government and supported by the taxpayers?

MR. FRAWLEY: Yes.

THE CHAIRMAN: They say that would arise unless they are allowed to have a fair return.

MR. FRAWLEY: Yes. All I say is that we will give them that. We will go along with them on that. We will allow them to remain the yardstick.

THE CHAIRMAN: Will you allow them to have what they call a fair return? The word "fair" of course is a word that is rather flexible. Your idea of a fair return might differ from that of Mr. Northey Jones.

MR. FRAWLEY: Oh, yes; I can say at once that it does. I am only seeking to ask the witness and not to propose anything. I am only seeking to ask him what he, as certainly the chief adviser on this point to the Canadian Pacific -- he is No. 1 in the batting order anyway -- thinks that the Canadian Pacific might be willing to give to the people of Canada in order to get this protection about which they are so fearful.

THE CHAIRMAN: Can you define the word "give" for me?

MR. FRAWLEY: This is just something that comes into the minds of the people. Suppose the people of Canada were told that the dividend rate was not going to be 5 per cent any more, that it now looked to them that 5 per cent under those circumstances was too much, that the fixed charge of paying 6 per cent in perpetuity in one class is too much, that the house must be put in order

because they have been saved from disaster. That is their case before this Commission, but apparently they are so self-confident that they offer nothing. They merely say it is absurd, that the Canadian Pacific must be saved at all costs. I say maybe not at all costs, that maybe some amelioration of the freight rates in Canada should be one of the first considerations.

THE CHAIRMAN: Would you recapitalize both the Canadian National and the Canadian Pacific? You are getting pretty close to that.

MR. FRAWLEY: That might be a consequence. I say quite seriously that there certainly is a large body of opinion. My friends feel so sure about it, but they may be terribly surprised. There may be a large body of revulsion of public opinion that, if the Canadian National is recapitalized and put in a better position, it should not be used as the yardstick, and that things must go on just as if the Canadian National had never been recapitalized. What good is recapitalization if after it is made things have to remain as they are now? We will hear from the Canadian National. I am only fighting their battle because I am interested in the people of Alberta who have to pay these monstrous freight rates because the Canadian Pacific must be the yardstick. Thank you, Mr. Northey Jones.

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CROSS-EXAMINATION BY MR. O'DONNELL:

Q. Mr. Northey Jones, will you please turn to page 18 of your statement?

A. Yes, Mr. O'Donnell.

Q. You have two figures there in the first full paragraph, $47,500,000 based on a return of 4 3/4 per cent

and $66,600,000 based on a return of 6 2/3 per cent on the Canadian Pacific property investment, I take it. Those two figures are after income tax?

A. That is correct. May I interject, Mr. O'Donnell, that those figures are not based on a return of 4 3/4 per cent. The Board's finding was based on a requirement which is equivalent to 4 3/4 per cent.

Q. You say:

> ". . . or a return of 4 3/4 per cent on the approximate billion dollars of capital invested in the railway enterprise" . . .

A. That is right. I just wanted to be clear that the finding was not based on a 4 3/4 per cent return theory.

Q. But the computation is that 4 3/4 per cent on the approximate billion dollars of capital invested in the railway enterprise would give, after income tax, the amount of $47,500,000?

A. That is right.

Q. And likewise the $66,600,000 would be the earning after income tax on a return of 6 2/3 per cent?

A. That is right.

Q. And all this is suppositious and merely for the purpose of illustration?

A. Correct.

Q. It is preceded by the word "if" as many of your proposals and suggestions are throughout. It is purely argumentative and illustrative?

A. That is right.

Q. If the $47,500,000 is after income tax I take it we could agree that that sum, after deduction from it of fixed charges, would be about $11,700,000 less, the fixed charges as found in that judgment to which you refer being $11,700,000?

A. $11,700,000, and it being a proportion of the $14 million plus fixed charges of the C.P.R.

Q. I think you will find it on page 7 at the top of the page and again on page 14.

A. Yes.

Q. So that after deduction from that sum of $47,500,000 the result would be an approximate surplus after fixed charges in the first instance of about $35,800,000?

A. Correct.

Q. And with respect to the second figure, $66,600,000, it would be an approximate surplus after fixed charges of about $54,900,000,deducting the same --

A. Deducting the same fixed charges of $11,700,000 which are only a proportion of the Canadian Pacific's fixed charges of $14,543,000.

Q. But those fixed charges as found by the Board at page 7 and again at page 14 of the judgment rendered on the 28th of February, 1950 --

THE CHAIRMAN: What judgment is that?

MR. O'DONNELL: That is the 16% case. It is the final disposition or determination of the 20% case which fixed --

THE CHAIRMAN: What do you call it commonly?

MR. O'DONNELL: I have called it the 16% case. I think that is generally accepted. It was originally an application for 20% and it was granted to the extent of 16 per cent, and in that connection --

THE CHAIRMAN: Rendered when?

MR. O'DONNELL: February 28, 1950. Incidentally in connection with that case your lordship and the other Commissioners will remember that there is a further application pending before the Board at the present time

for the granting of the additional --

THE CHAIRMAN: What page is it?

MR. O'DONNELL: I referred to page 7 and page 14 concerning the computation of the requirements of the C.P.R., and particularly the figure of fixed charges to which I have just referred.

Q. Now, Mr. Northey Jones, in order that this approximate surplus of $35,800,000 after income tax and fixed charges should accrue to the Canadian Pacific have you made any computation of the additional increase in freight rates which would be required to produce that figure?

A. No, I have not, Mr. O'Donnell.

Q Well, are you aware of the fact that even if the full 20% were to be granted, that is the additional 4 per cent that is presently under consideration by the Board of Transport Commissioners, that that would not produce the figure of $35,800,000 or your other figure of $47,500,000?

A. I understand that to be so. I have not made that computation, but I understand that is so.

Q. Under my instructions it would require an increase of 5 per cent at least. Would your answer be the same in connection with the other figure of $66,600,000 after income tax, or an approximate surplus of $54,900,000 after deduction from that figure of fixed charges? Have you made any computation there as to what additional freight rate increase would be required to produce such a surplus?

A. No, I have not.

Q. Again under my instructions the rates would have to be increased by approximately 24% over the present 16%. I wonder if you would be good enough to make that

computation and check it at your convenience? I am speaking in round figures only, and if you find it is out of line you might have counsel advised.

MR. EVANS: I wonder whether Mr. Jones is capable of calculating that unless he goes to the exhibits from which the original figure is derived.

THE CHAIRMAN: Just what is your proposition again?

MR. O'DONNELL: My question to Mr. Jones, my lord, was whether or not he could tell the Commission if the figure that I am instructed is the figure --

THE CHAIRMAN: What figure?

MR. O'DONNELL: 24%, in order to get this surplus after income tax and after payment of fixed charges.

THE CHAIRMAN: The surplus of $66,000,000?

MR. O'DONNELL: Yes, referred to on page 18 of his statement. In order to get that, the efficiency of the operation and all other matters being constant and things being as they are at the present time, to provide $66,600,000 after payment of income taxes, or an approximate surplus of $54,900,000 after payment of fixed charges there would have to be an increase in freight rates as at present of 24%, and the 16% which has been recently granted would have to be increased to 40%.

THE CHAIRMAN: Are you saying you are instructed that?

MR. O'DONNELL: Those are my instructions, and I am asking Mr. Northey Jones to check that at his convenience, and if he finds it is wrong he can advise the Commission through counsel.

COMMISSIONER INNIS: Yesterday Mr. Northey Jones suggested that he revised that figure downward to $63 million.

THE WITNESS: Yes, sir.

THE CHAIRMAN: Q. Instead of $66,600,000?

A. Yes. I would suggest if that question could be asked the Canadian Pacific accounting people rather than myself --

MR. O'DONNELL: I have no objection. I assume for the purpose of convenience they will do it for you, and that will end your trouble.

THE CHAIRMAN: In doing it the figure to be used would be $63 million instead of $66 million.

MR. O'DONNELL: That is quite all right. I have no objection to the -- what was your figure?

THE WITNESS: $63 million. A rough calculation is that means in respect of the $47,500,000 an increase of $15,500,000. Because I am not wholly familiar with just what types of traffic would bear that rate increase and the proportion that would bear no rate increase under the Crows Nest Pass agreement and other things, I could not of my own knowledge tell you at all what rate increase would be necessary to produce the extra $15,500,000, but I shall consult with the Canadian Pacific accounting people and see what their computation is as to what would be necessary, all other things remaining equal.

MR. O'DONNELL: Q. That is right.

A. Although I said I expected there would be some increase in efficiency.

Q. I am taking the position as it is today.

A. Right.

Q. And all other things being constant I am putting the proposition to you on that basis. You mentioned that figure of $63 million --

MR. CARSON: I wonder if you would mind letting us have your working papers showing how you arrive at

that figure.

MR. O'DONNELL: I shall be glad to do that.

MR. CARSON: I don't know if Mr. Jones can very conveniently do that.

MR. O'DONNELL: I am putting it to you. You can check it at your convenience, and if my instructions are wrong you can inform the Commission.

MR. CARSON: I just thought that as from one person to another you would let us have your working papers.

MR. O'DONNELL: Oh, yes. I shall be glad to have our representative confer with his man.

THE CHAIRMAN: It will expedite matters.

MR. O'DONNELL: Certainly; I have no objection at all.

COMMISSIONER ANGUS: You spoke of a figure of 5 per cent. That was in addition to the 20 per cent, was it?

MR. O'DONNELL: The 21% case has been disposed of. That is in these figures, and in addition to the 21% the Board granted a 16% increase, and presently has pending before it an application for the remaining 4% to make it 20%.

COMMISSIONER ANGUS: Yes.

MR. O'DONNELL: There is only 4% under consideration by the Board at the present time. My suggestion to Mr. Northey Jones is that even that 4%, making a total of 20%, would not be sufficient to produce this approximate surplus we have referred to of $47,500,000.

COMMISSIONER ANGUS: Would it need 5% in addition to the 4%?

MR. O'DONNELL: No, one per cent over to produce that particular figure, but when we get to the figure of $66,600,000, on my understanding it would require

approximately 24% over the 4%.

THE WITNESS: Over the 4% or in place of the 4%?

MR. EVANS: Perhaps my friend would point this up by saying what attitude his company would take.

MR. O'DONNELL: I will point it up in due time. I am merely trying to end with Mr. Northey Jones as quickly as I can. I have only a question or two more. I assume we will have to argue about it later.

MR. EVANS: Are you opposing an increase to give us a fair return, Mr. O'Donnell?

MR. O'DONNELL: I do not think we have ever opposed any increase that would give you a fair return, and I do not think we ever will.

THE CHAIRMAN: In any case are not these figures here being used for this purpose? Whether you take the figure of $47,500,000, which the Board took, or the larger figure of $63,000,000, as it now is, which Mr. Northey Jones puts forward, in either case it seems reasonable to suppose that the Canadian National should earn at least $50 million a year before income tax.

MR. O'DONNELL: That is what I am getting back to; that is right.

Q. Taking that other figure you used of $63 million after income tax, if we in that case deducted the fixed charges that would leave an approximate surplus after fixed charges, using that particular figure, of about $52 million?

A. Using again this Board figure for the fixed charges, and the Board says, "By adoption of the revised formula for the apportionment of fixed charges", and which is only a part of the fixed charges of the Canadian Pacific.

Q. I am assuming that is constant in each one of these cases, and all that is changed is the earnings.

A. Right.

Q. In the case of the figure of $63 million after deduction of fixed charges the figure would be roughly $52 million?

A That is correct.

Q. I take it likewise in this case you have made no computation of the increase in freight rates which would have to be put into effect to produce that figure of $52 million?

A. That is correct.

Q. Now, using the same percentage of freight rate increases, or the same rates of return, have you made any estimate of the Canadian National net earning after fixed charges on their adjusted basis, and after payment of income tax on the same basis that the Canadian Pacific tax is paid?

A. I have not made any such estimate. There are, as I understand it, certain computations in the record which I have read.

Q. You have not made them?

A. I have not made those, no, sir.

Q. Then, would you please tell me how you arrive at the figure of $35 million on page 18, and the figure over on the next page of $60 million which is a supposition, I take it. You say:

> ". . . it seems reasonable to suppose that the Canadian National with its larger system and greater gross revenues, should earn at least $50 million a year before income tax."

Again you have not pursued this supposition, and you are putting it forward for the purpose of illustrating your argument?

A. That is correct.

Q. You have made no --

A. That is, of course, a figure of $50 million on $500 million of gross revenues, and it would mean that the operating expenses would consume 90 per cent and that there would be 10 per cent left over.

Q. That is a rough rule of thumb calculation but not based on any study that you have made?

A. No.

Q. Then, please tell me if you have made any study -- I assume you have not -- in arriving at that figure of $35 million?

A. The figure of $35 million is a derivative from the $50 million.

Q. Again it is made simply as a matter of arithmetic and without any study of the details?

A. Without any study of the details but with some estimation of or some consideration of what the growth in traffic in Canada may be, and some consideration of what economies and savings may be, and some consideration of what may result from rates which have been asked for.

Q. With respect to growth of traffic in Canada I think you said very fairly and frankly that in so far as Canadian National is concerned you are prepared to leave that to the judgment of the officers of the Canadian National who have full information and details concerning that?

A. Yes.

Q. And whose judgment you thought was better in the circumstances?

THE CHAIRMAN: What is it that Mr. Northey Jones is prepared to leave to the discretion of the management?

MR. O'DONNELL: His estimate as to the growth.

THE WITNESS: The estimate of the growth of traffic for the Canadian National.

MR. EVANS: I do not think my friend puts it quite clearly when he says that Mr. Northey Jones said he would leave it to their discretion.

MR. O'DONNELL: We will let the record speak for itself.

THE WITNESS: Mr. O'Donnell, maybe to clear this up, I want to be fair about this, I said in my judgment as a man from the United States that in my opinion railway traffic in the United States in the 1950's would be larger than in any decade except the 40's, which included the war, and that in Canada I thought the 1950's would exceed any decade except the 1940's, and might even exceed the 1940's because you have less truck competition in Canada than we have in the United States, and you also have an expanding economy up here so that your traffic is growing. Then I think somebody asked and I then said that as to actual details of estimates of the volume of traffic which will move in the 1950's the officials of the Canadian National are much better able to estimate than I as to what that volume will be.

(Page 20598 follows)

MR O'DONNELL: Q. I haven't any quarrel with that, and the record will show, I think, that that is what you said.

A. I think that straightens that out.

Q. We can agree, I take it, right away that the economy of Canada is on a different level to that of the United States?

A. That is right; but also I would say that your percentage of expansion is probably greater.

Q. We have a better chance, possibly, to expand; on the other hand, we may not, and nobody knows?

A. Well, there are signs of it at least, I mean signs of it in Alberta with oil, and there are signs of it in the east with iron.

Q. But, in any event, getting back to what I have in mind, we agree that the economy in Canada is on a different level; we have a different level of freight rates, for instance?

A. Correct.

Q. Different levels of remuneration for labour, and we have different prices throughout our entire price structure?

A. That is correct.

Q. And now with respect to truck competition, you say that you have more of it in the United States, and I assume that is correct, as at this point, but you are aware of the fact that truck competition in Canada has grown tremendously in the last few years?

A. Yes.

Q. And it is expected to grow more, is it not, on the information that you have -- or have you any information?

A. Well, I have not real information on that subject. I would venture a guess that it might continue to grow.

Q. And as to the effect of that type of thing as well as these other matters of the differences in levels of the economy, you very frankly said you thought -- on my interpretation, at least -- that in so far as the Canadian National Railway was concerned, its officers were in a better position to judge those over-all effects than you are?

A. Well, I think I was a little more specific, that I thought that the officials of the Canadian N tional were better able to estimate the traffic potentialities than I was.

Q. Well, that is good enough for my purpose.

My lord, in so far as I am concerned, Mr. Northey Jones' testimony, as he very frankly agrees, and as his statement shows, is largely a matter of argument, and, as was suggested yesterday by your lordship to Mr. MacPherson, I think that it might be more satisfactorily dealt with in argument, and accordingly I will not detain the Commission---

THE CHAIRMAN: What I was trying to point out to Mr. MacPherson yesterday was that all that is advanced on page 18 is preceded by an "if".

MR O'DONNELL: That is right; and there are thirty-five or six "if's" throughout the statement. That is what makes me say it is largely argumentative.

THE CHAIRMAN: If the Canadian P cific remains the standard, then in that case whether you take the $47,500,000 or the $66,600,000, now reduced to $63 million, which Mr. Northey Jones says he testified before the Commission was the proper figure, in either case he says the C.N.R. under its projected recapitalization, with its larger system and greater gross revenues, should earn at least $50,000,000.

MR O'DONNELL: That is what he thinks seems reasonable. That being the case, I will not detain Mr. Northey Jones or the Commission longer with respect to that. I know he is very anxious to get away.

THE CHAIRMAN: Probably -- I don't know -- maybe you will argue later that this is an erroneous conclusion.

MR O'DONNELL: Yes, my lord; and I may have some brief evidence to adduce to clarify one or two points referred to there.

I thank you very much, Mr. Jones.

THE WITNESS: Thank you, Mr. O'Donnell.

THE CHAIRMAN: Anybody else?

MR CARSON: I have one or two questions in re-examination, my lord.

THE CHAIRMAN: All right, Mr. Carson.

RE-EXAMINED BY MR CARSON:

Q. Mr. Northey Jones, yesterday right after the luncheon adjournment Dr. Angus put two or three questions to you, to which I would like to direct your attention. At page 20496 he was asking you about the wage for capital that was necessary to raise money in the money markets, and then about two thirds of the way down the page he put this question that I read:

"Q. So that the effect might be, I think, to have quite an appreciable increase in railway rates in order to enable the Canadian Pacific to acquire a relatively small amount of capital?

"A. That, Dr. Angus, in the case of the Canadian Pacific, just the extent of that increase in rates, is a question. There is not only the increase in rates, but there are the economies in operation and there is the possibility of a growth in business in the number of

ton miles hauled. In addition, in the Canadian Pacific they are, in a way, in a fortunate position in having a substantial Other Income, and the market price of their stock is dependent not only on the rail income, but also a big factor in it is what they get from Smelters, so that actually to sell Canadian Pacific stock at 25, the ability to do that may be helped greatly by the Other Income coming from Smelters."

Coming back particularly to the way Dr. Angus put his question, that the effect might be to have quite an appreciable increase in railway rates in order to enable the Canadian Pacific to acquir e a relatively small amount of capital, have you given any more thinking to that over night, Mr. Northey Jones?

A. Mr. Carson, I think I might expand my answer to Dr. Angus, to the effect that an increase in rates to acquire a relatively small amount of capital, that increase in rates would not be only for that purpose, but that there should be a fair return at all events on the capital that is in the enterprise now, and that if there is to be that fair return, then the railway will be put in a position that it can get relatively small or maybe larger amounts of new capital.

COMMISSIONER ANGUS: I think perhaps my question was directed to this, that the argument for the Canadian Pacific seemed to rest on two bases. One was necessity -- "We cannot get capital unless we can meet the market rate." The other was fairness -- "It is fair that our shareholders should get this return on their investment." Now, I tried to separate those two things so that we should not be concentrating on necessity if the essence of the matter were, as Mr. Northey Jones says, fairness.

MR CARSON : Q. What do you say as to that?

A. My answer to that, Dr. Angus, is that I would think that both elements have to be considered -- that is, fairness to the existing stockholders, and the necessity of meeting the market in obtaining new capital.

Q. I gather your view is that if a fair return was made to the existing stockholders, the other will follow, that they will be able to raise new capital?

A. That is correct, Mr. Carson.

MR CARSON: Does that clear it up?

COMMISSIONER ANGUS: Yes. I think perhaps the point will come up in argument later. It seemed to me throughout that the Canadian Pacific case, by stressing necessity, had rather avoided having to produce as much argument as they might otherwise have to produce on the point of fairness.

MR CARSON: I do not think that was intentional. It may have been at a particular moment in a particular discussion that one point or other received emphasis, and it may be that over all more emphasis has been given to one than to the other, but we do not draw a distinction. Mr. Northey Joneshas said both are of importance to the Canadian Pacific.

COMMISSIONER ANGUS: I was trying to enforce the distinction by a hypothesis that met the necessity, and then leave fairness to stand on its own merits.

MR CARSON: Yes. Well, I wanted to get any further thinking Mr. Northey Jones had on it, and I do not think I can develop it any further at the moment.

Q. Now, one other question that was put to you by Dr. Angus, commencing at the bottom of page 20497 and running on to page 20498. He was asking you about the possibility of the Government buying stock in the Canadian Pacific. Then twoards the end, at the bottom of page 20497, Dr. Angus,

having put that hypothesis, put this to you:

"Now, would you consider an arrangement of that sort -- and if this is not a fair question, do not answer it-- would you consider that an arrangement of that sort was unfair or unjust to the existing shareholders?

"A. This is my own opinion. I would not think that an arrangement of that sort would, of itself, as far as a financial transaction, be unfair. The question might arise that if the Government were to buy this stock at 25, would they expect to get a return on that? If the situation were to arise that the Government would not expect to get a return on that, and by their not expecting to get a return on that $25.00 per share they put in, resulted in the other common stockholders not getting a return on that investment, I believe that the other stockholders would feel that they were not in a good position.

"Q. I can see that. But for the Government to expect to get something of the order of 4% does not require as high a level of rates as for the stockholders in general to expect to get something of the order of 6 2/3%?

"A. That is correct, sir."

Now, have you given any more thought to that subject of discussion, Mr. Jones?

A. Well, I think that enters really the same point that we have just been discussing, that if a stock were to be sold to the Government at $25 a share, that should not be the means of avoiding the old stockholders being able to receive a fair return on their investment.

Q. Then when you were being cross-examined I think by Mr. MacPherson in connection with recent financing, Mr.

O'Donnell pointed out that the rate on the recent issue was 3-1/8 per cent. Have you anything to say about the factors that affected that rate, Mr. Jones?

A. Well, I think the factors that affected that rate that the Canadian Pacific was able to obtain were the fact that this obligation is backed by the general credit of the Canadian Pacific, which includes its investment and earning not only in the railway enterprise but in its Other Income from its holdings in Smelters and other enterprises. It is also affected by the fact that there are pledged to secure these twenty-year bonds, Canadian Pacific perpetual debenture fours in an amount in excess of the priccipal amount of these bonds, and the Canadian Pacific was further aided in being able to get a favourable market reception to its issue because there is a speculative feature in the issue, in that the bonds are convertible into Canadian Pacific stock, and there is some chance, some hope, at some time that the stock will sell over 25, and if so there will be a profit there.

Q. Then, Mr. Jones, someone put a question to you yesterday -- I am afraid I have forgotten who it was -- that dealt with the cost of money today, and your answer rather, as I recall it, developed that you were thinking more about the cost of debt money today, and I am not sure whether you said anything about the cost of equity money today. Have you anything you would like to say on that?

A. I went into the cost of debt money.

THE CHAIRMAN: What are the two classes of money?

MR CARSON: Debt money and equity money.

THE WITNESS: In other words, the sale of bonds as compared with the sale of shares. I did not go into the question as to the sale of shares, but we see that today Canadian Pacific stock, which earned a little under $2 last

year, $1.93 a share, dependent as it was upon their Other Income, the price of the stock is about $18, or it is selling about 9 times earnings, or, expressed in a percentage basis, it is on an 11 per cent earning basis.

Now, the Atcheson, Topeka & Sante Fe, which is one of our outstanding leading railroads in the United States, earned $18.06 a share in 1949, and it is selling at $112 a share, or 6.2 times earnings. That is a basis of about 15 per cent, which is a figure at which a railroad would not want to go to the markets and sell stock, if they have to in effect earn 15 per cent on money which is invested in the enterprise. Now, those figures vary for different railroads.

The Union Pacific, which is one of our leading railroads, earned last year $10.26 a share. It is selling at a price of 85¼, which is 8.3 times the earnings, or on a 12 per cent earning basis.

MR O'DONNELL: Q. That is the Union Pacific?

A. That was the Union Pacific. So we see that this figure that I talked about of 10 per cent that should be earned on a railway common stock, you can invest in the United States in railways where you get more than 10 per cent -- that is, on an earnings basis; that is not the dividend basis -- and similarly here in the Canadian Pacific: If you invest $18 a share and you get earnings of $2 a share, it is not all distributed in the form of dividends, but you get an 11 per cent earning return on that, of which a part is paid to you in the form of dividend and the other is withheld and retained by the directors to be reinvested in the property, with the thought that that will increase the value of the property and the stock in the future.

MR CARSON: Q. Then, Mr. Jones, in connection with the earnings on common shares, where you were speaking about

10 per cent earnings, Mr. MacPherson was quoting from your evidence in the 20% Case at page 2578. I just want to put beside that, without asking you any question about it, another question and answer that was put to you on the same page, that clarifies what you meant by 10 per cent. Mr. Priest asked the question:

"Q. When you say earnings of 10%, you do not contemplate dividends of 10%, do you?

A. No, no. If the earnings were 10%, I would contemplate payment of a fair dividend which, in my opinion would be about 50% of those earnings, or about a 5% dividend, with 5% reinvested in the railway property."

And I think you said the same thing in effect here today?

A. Yes.

Q. Thank you.

MR O'DONNELL: While you are here, Mr. Northey Jones, could you give, as a matter of curiosity, the figures for the Pennsylvania and New York Central, what they are selling at and what their earnings are?

A. I am afraid I have not got the New York Central figures with me. The Pennsylvania Railway figures, to get them on a comparable basis with the figures that I presented a year and a quarter ago, I have to go to the I.C.C. reports, because the figures that are generally reported for the Pennsylvania Railroad are the Pennsylvania Railroad Company figures, and there is a difference between the system and the company. Actually Pennsylvania Company figures for 1949 show earnings of 95¢ a share, and the market price of Pennsylvania is 17¼, which means that the stock on the basis of those earnings would be selling for about 18 times earnings, or on about a 5½% basis. Now, I might say that that figure is lower than the others, because there was an abrupt decline

last year in the Pennsylvania earnings, and I think that the general feeling is that they will not be that low. Now, I can give you another example of that same kind, Mr. O'Donnell---

MR O'DONNELL: Q. Just before you do that, would you give us the New York Central figures, if you have them?

A. No, I have not got them, I am sorry.

Q. Would you be good enough to drop me a note, so that I can have them?

A. I will be glad to.

Q. I would be glad to have your assessment of the position.

A. And also I will give you a system figure for the Pennsylvania.

Q. Thank you, Mr. Northey Jones.

COMMISSIONER INNIS: Q. Has the cost of marketing securities as far as railroads are concerned gone up in relation to other securities, or are they sold on the same footing? I mean the actual commission charges for handling the---

A. The securities that have been sold have generally speaking been of the railroads with the better credit. I would say that what we call the spread, in other words the difference between what the banker pays the corporation and what he resells it to the public for, is somewhat less in public utilities and in the best of industrials than it is in the best of railroads, but very little different. The spreads on some of these issues -- I mean, take telephone issues, which are considered to be among the very highest, although they are not rated as high in relation to electric and gas securities as they were before this tremendous volume of them had to be sold, but the spread on a number of these issues approaches just half of one per

cent. Now, in the railroads it might be somewhere in between a half and one per cent.

THE CHAIRMAN: Thank you, Mr. Northey Jones. We will take a few minutes now.

(Recess)

(Page 20609 follows)

MR. CARSON: My lord, the next witness I present is Mr. Henry Gordon Norman, senior partner of the Price, Waterhouse accounting firm in Canada. If it please the Commission, I will ask Mr. Norman to proceed; that is, to read the statement he has prepared, and that was made available --

THE CHAIRMAN: Have we a copy of the statement?

MR. CARSON: I believe so, my lord, yes. Copies of the statement were made available some days agaio Mr. O'Donnell, Mr. Covert and counsel for the provinces.

MR. HENRY GORDON NORMAN - Called

EXAMINATION BY MR. CARSON:-

Q. Will you proceed, Mr. Norman, and read your statement, which introduces you and which, by way of introduction, tells about your qualifications and experience?

A. Yes.

My name is Henry Gordon Norman and I reside in Montreal.

I am a Chartered Accountant, being a member of the Quebec, Alberta and New Brunswick Institutes and having been a member of the Alberta Institute since 1915.

I am a member of the Firm of Price, Waterhouse & Co., and have been the senior partner of that Firm in Canada since July 1, 1948. The Firm of Price, Waterhouse & Co. is associated with partnerships having the same name organized under the laws of the United States, Great Britain and a number of other countries. The Firm of Price, Waterhouse & Co. in Canada are the auditors for the Canadian Pacific Railway Company.

After my return from the First Great War, I was associated with the Firm of Price, Waterhouse & Co. in the United States, in Philadelphia, and returned to Canada in 1931, becoming a partner in the Canadian Firm on July 1, 1932.

Since my return to Canada in 1931 I have held the position of President of the Dominion Association of Chartered Accountants and President of the Institute of Chartered Accountants of Quebec. During the last war I served in the capacity of Financial Advisor to the Commonwealth Air Training Plan, being responsible to the various governments participating in that Plan, and was also Financial Advisor to the Minister for Air.

I have reviewed the Submission of the Canadian National Railways to the Royal Commission on Transportation, and the statement made to that Commission by Mr. Gordon. I have been requested by the Canadian Pacific Railway Company to analyze and comment upon the principal proposals made by Mr. Gordon, giving particular attention to those aspects of such proposals which, if carried out, would, in my opinion, have an adverse effect upon the Canadian Pacific Railway Company and which I believe might ultimately make it impossible for it to continue its existence as an investor-owned railway.

Before commenting on any of the above mentioned submission testimony, I would like to refer to certain matters which appear in various reports and which are a matter of record.

THE DRAYTON-ACWORTH REPORT - 1917

I would refer you to page 44 from which the following is quoted:-

"The C nadian Pacific Railway is exposed throughout its whole territory to the competition of either one or both of the other systems. So long as thet competition is in the hands of other organizations, also having to earn the interest on their bonds and striving to earn a dividend on their stocks, the Canadian Pacific Railway has no cause for complaint. But competition with railways operated by the Government stands on an entirely different footing. It would be at any time possible for the Government deliberately to adopt a policy of lowering rates, in some part or throughout the territory involved, below a commercial basis, and making up the deficiency out of general taxation. It might be argued that such a policy was justifiable on the ground that the general prosperity and development of the country would be thereby promoted. But while conceivably it might be proper to tax the public to develop the country, though in fact it would not be the whole public but only certain portions of it that would benefit, it could not possibly be fair to impose a special tax upon the Canadian Pacific Railway shareholders for the purpose. And yet it is evident that this would in fact happen. The Canadian Pacific Railway would be absolutely

forced to follow any rate reduction made by the Government railways, on pain of losing the business entirely."

I would refer you also to page 72 under the heading of "Operation to be on a Commercial Basis" from which the following is quoted:-

"We would go further and lay it down in terms in the Act of Parliament creating the Board of Trustees that it was the duty of the Trustees to operate their system as a commercial concern, and to make no general reduction in rates, unless ordered so to do by the Railway Commission, until interest at a reasonable rate was earned on the whole capital value....."

Those underlinings are my own.

.....of the undertaking. And this for two reasons. We believe that the obligation to work the system as a commercial concern in competition with a well established and well equipped rival will be a stimulus to efficient and economical management. And further we think that reductions, in favour of certain classes of business and certain commodities, which bring the railway rates below a reasonably remunerative basis, are wrong in principle. Their effect is to conceal the fact that a bounty is being given to certain persons and certain places at the expense of the community at large. If bounties are to be given, as to which it is not for us to express an opinion, we think they should be openly voted by Parliament, and not given under the disguise of a railway

rate reduced to an unremunerative basis."

MR. CARSON: Before you leave that page, may I say that Mr. O'Donnell has been good enough to call my attention to the fact that the first quotation from the Drayton-Acworth report is from page 45, not page 44.

THE WITNESS: Then will you change that to 45.

THE CHAIRMAN: Does this report go on to give instances of these reductions in favour of certain classes of business and certain commodities that were then in effect?

MR. CARSON: I have not a copy of it here, my lord; but we will look it up.

THE CHAIRMAN: Had they in mind something that then was in fact the case or were they simply apprehending something that for the future ought not to be?

MR. CARSON: My lord, I would not like to make an answer at the moment. We will take another look at the report.

MR. O'DONNELL: They are speaking there of the Intercolonial and the Transcontinental only. They are not speaking of the Canadian National as it is today. They do not go into instances.

MR. CARSON: We will look it up, my lord, and refer to it at a later time.

THE CHAIRMAN: Yes.

MR. CARSON: Will you continue, Mr. Norman?

A. Yes.

REPORT OF THE ROYAL COMMISSION TO INQUIRE INTO RAILWAYS AND TRANSPORTATION IN CANADA, 1931-1932

I would refer you to paragraph 189 on page 60, from which the following is quoted:-

"It would appear that, at the moment, any adjustment of the freight tolls and tariffs would be inadvisable, but we feel it our duty before passing from this question, to express the view that even under more favourable circumstances the financial position of the railways may be such as to demand that the whole question of tariffs and tolls, in its widest sense, should be the subject of special investigation, with a view to determining whether or not the existing tariffs and tolls charged for the conveyance of freight are just and ressonable both to the railways and their customers. In determining what is fair and reasonable to the railwaysregard should be had inter alia to the cost (including the remuneration of the capital invested) of providing these services."

The underlining is also mine, sir.

I would further refer you to paragraph 206 on page 64 which reads as follows:-

"Since the debt of the System in the hands of the public is now very large and more than the railway can carry from its earnings even under improved conditions, sums which are required to meet deficits should be voted by Parliament annually and not raised by the issue of railway securities as has been done in recent

years. This recommendation does not apply to capital for improvements and betterments nor to amounts required for refunding."

MR. CARSON: Q. There again the underlining is yours?

A. That underlining there is mine also.

Q. Yes. Will you continue?

A. Yes.

In order that you may have the proposals before you, I quote from Mr. Gordon's summarization as follows:-

"(1) The $760,000,000 of interest-bearing obligations held by the Government should be exchanged for equity capital and reflected in the balance sheet as such.

(2) The Government should acknowledge an indebtedness to Canadian National in the amount of $300,000,000 to bear interest at 3% until discharged. This would be set up in the accounts of Canadian National as a capital fund to be drawn on from time to time to retire interest-bearing obligations in the hands of the public or for capital additions to the property. As consideration for the acknowledgment of the indebtedness aforesaid, Canadian National would issue a commensurate amount of equity stock to the Government.

(3) Future development lines should be financed to the extent of not more than 60% by interest-bearing securities, the balance to be supplied by the Government against the issue by Canadian National of a commensurate amount of equity stock."

(4)....."The task of Management would be greatly eased, in my opinion, also concurred in by the Board of Directors, if there were a recommendation from your Commission that the Board of Canadian National use such surplus earnings (a) to provide sufficient funds to cover expenditures for non-revenue producing improvements and betterments; and (b) to establish a rate stabilization fund which it is hoped could be built up in good years and drawn upon in poor years with the view of affording stability to the rate structure and tending, to the extent of the fund from time to time existing, to postpone the necessity of applications for general freight increases. Your Commission is respectfully invited to recommend the proposals which I have just made regarding this subject."

THE CHAIRMAN: That is withdrawn.

MR. O'DONNELL: Yes; that is withdrawn. I do not see why that is referred to in this statement.

MR. CARSON: He deals with that later.

MR. O'DONNELL: It is difficult to understand how it can be dealt with when it is deleted, withdrawn and not before the Commission.

THE CHAIRMAN: What good purpose does it serve in that statement now?

A. My lord, I deal with this later in bringing out the points that the surplus which was to be dealt with in this way will not be available to the Canadian National.

MR. O'DONNELL: You can do that in some other way

than by referring to something that is not before the Commission.

THE CHAIRMAN: Well, go on.

MR. CARSON: I think you will see how it is developed later on.

Q. Will you continue?

A. Yes.

Beofre dealing with these four points I would like to discuss certain remarks made by Mr. Gordon in his statement to the Royal Commission on Transportation.

On page 18373, Mr. Gordon refers to the fact that the historical record is only of value as offering some basis for forecasting future results and indicates that the earning power of the C.N.R. from 1923 to date shows wide fluctuations which cannot be taken as indicative of the situation which can be expected to prevail normally or in the future.

In this connection I would point out that the gross revenues of the C.N.R. had a continued up-trend from 1946 to 1949 in which latter year they reached an all time high of $500,000,000. The undernoted figures, taken from Table 3 appearing on page 33 of the Submission and the printed annual report of the company for 1949, Exhibit 254, show a continued increase in the deficit of each year from 1946 to 1949 inclusive.

	GROSS REVENUES	NET REVENUES	NET INCOME AVAILABLE TO PAY FIXED CHARGES	FIXED CHARGES	NET INCOME OR DEFICIT (-)
1940	$247,527,225	$ 45,007,412	$ 36,340,244	$ 53,305,288	$ -16,965,044
1941	304,376,778	66,608,241	57,178,681	53,162,354	4,016,327
1942	375,654,544	86,655,869	76,733,203	51,669,935	25,063,268
1943	440,615,954	116,140,285	87,828,948	52,189,536	35,639,412
1944	441,147,510	78,600,467	73,501,404	50,474,480	23,026,924
1945	433,773,394	78,479,345	73,765,637	49,009,507	24,756,130
1946	400,586,026	43,340,308	37,723,746	46,685,316	- 8,961,570
1947	438,197,980	41,075,370	30,040,697	45,925,891	-15,885,194
1948	491,269,950	26,529,980	12,808,986	46,341,727	-33,532,741
1949	500,723,386	22,221,726	6,588,869	48,631,896	-42,043,027

JC

However, if the imbalance as between costs of wages and materials and revenues had been reduced in these years within one month of the application for rate increases and to the extent of the additional freight rates now granted in respect of each application, the deficit for 1946 would have been reduced to $2,097,000, the results for 1947 would have shown a surplus of $25,300,000 and the deficit for 1948 would have been reduced to $13,201,000. As shown by Exhibit 257 there would have resulted a deficit of only $1,575,000 in respect of the year 1949. This latter deficit is, however, after charging as an expense $3,826,000 representing the 5% premium on bonds called for redemption in 1949 and unamortized discount thereon, also after the inclusion of the operating losses of the Newfoundland railway and steamship services of over $2,500,000, as indicated on pages 9 and 7 respectively of the C.N.R. annual report for 1949, Exhibit 254.

This would certainly tend to show that some further correction in the imbalance between costs and rates would enable the C.N.R. to cover comfortably the present fixed charges, provided there is no further major increase in labour an material costs.

A table appearing on page 11 of the C.N.R. Submission shows estimated results at various levels of revenue on a downward trend, which the Submission on the previous page indicated was anticipated; all of these estimates appear to assume it to be a foregone conclusion that revenues will be reduced and at no time will there be an increase. Surely we cannot take it that Canada is going to stand still either in the growth of population or in the expansion of economic activities throughout the country. I am of the opinion that there

will be some measure of growth both from a population and an economic viewpoint and, if such is the case, the whole of the transportation facilities needed to service such growth will certainly not be furnished by other than railroads. Cannot we take a viewpoint that is a little more optimistic and forecast, not immediately of necessity, that in the future an increase in population and national income will be reflected, in part, in greater use of railroad facilities than we have seen heretofore?

In this connection I would refer you to the annual report of the C.N.R. for 1949, Exhibit 254, which on page 18 referred to the discovery of a major oil field in Alberta, around Edmonton, most of it being serviced by the C.N.R., and further indicated that it had been necessary, in order to provide a service to these oil fields, to construct a certain amount of additional trackage in order to move in large quantities of materials. To my mind this is indicative of a trend towards economic expansion rather than stagnation or retrogression.

On page 18374 of his statement, Mr. Gordon remarks that due largely to inflation rolling stock of the C.N.R. stands in its accounts at figures far less than replacement costs. This is not a problem peculiar to the C.N.R. but is extant with the C.P.R. and with most of the large industrial enterprises in Canada. This position should be overcome by the consumer paying sufficient additional charges, which, over a period of time, will meet the additional costs of replacements and which in the meantime may have had to be financed by borrowings.

In this particular connection I would refer you to the first report and accounts issued by the British Transport Commission which on page 196 states "As and when earnings are

available for the purpose, it is intended to make further allocations out of profits year by year to a replacement reserve towards meeting the increased cost of replacements as compared with the gross book values upon which the depreciation provision is computed."

MR. CARSON: We have been able to obtain a few copies of that report which we would like to make available to the Commission, if we may. Mr. Belcourt, would you be good enough to give them to the Commission. That will be Exhibit what?

MR. BELCOURT: Exhibit 275.

EXHIBIT 275...filed by Mr. Carson : Copy of First Report of British Transport Commission.

COMMISSIONER INNIS: Q. In the preceding paragraph, Mr. Norman, I assume that you did go so far as to say that there is almost an exact parallel between the C.N.R. and the C.P.R. with regard to the position of their equipment?

A. I would say, reasonably close.

Q. You have not checked that?

A. No, I have not checked any of the C.N.R. figures, because I have no knowledge whatever of how they are computed.

MR. CARSON: Q. Will you continue, please?

A. Yes.

As I have referred to the report and accounts of the British Transport Commission, I would also point out that the Consolidated Balance Sheet of the British Transport Commission, page 182 of the report:, shows that of the Capital Liabilities £1,131,956,540 is represented by "British Transport Stock" which as shown by schedule V-15, page 260

of the report, all bears a fixed interest rate of 3%. The amount of this interest for the year 1948, which was charged to the Revenue Account of the British Transport Commission amounted to £33,094,196, see schedule IV-8, page 236 of the report. Thus it will be seen that in England, the national undertaking is required to pay a fixed return on its entire capitalization.

The question of the construction of additional branch lines for the purpose of developing the natural resources of the country is referred to by Mr. Gordon on page 18374. If such branch lines are constructed at the request of the Government for national policy purposes they should be looked upon as Government enterprises. If construction is undertaken as a means of tapping major sources of revenue then freight rates should always be at such a level so that either there would be earnings available at all times to cover the cost of such development, or such costs could be financed temporarily through borrowings with a view that ultimately the net revenues from such additional construction will be sufficient to yield a reasonable return on property investment and also sufficient to retrieve the interest paid during the earlier years after construction.

In regard to Mr. Gordon's statement, commencing at page 18383, dealing with the effect of acquisition of unremunerative lines in national interest, there is no question in my mind but that operations such as the Newfoundland Railway and Steamship Services should be segregated and operated purely as an agency for the Government and the Government should meet deficits, if any, through annual appropriation .

In the C.N.R. Submission, Chapter 3, page 12, one of the reasons given for its financial difficulties is that the C.N.R. is obliged in the public interest to operate

without due compensation as a matter of national policy and as an instrument of national development considerable mileage of marginal and non-paying lines.

The C.P.R. has its loss lines and marginal lines in a proportion comparable to that of the C.N.R. in relation to its total mileage as evidenced by the undernoted statistics.

The figures for the C.N.R. are extracted from pages 70-71 of their Submission, Chapter 3, and those of the C.P.R. have been extracted from Exhibit 191, filed by the C.P.R.

(Page 20626 follows)

THE WITNESS: Do you wish me to read these figures, Mr. Carson?

MR. CARSON: I think those figures speak for themselves. Unless the Commission wants them read we will pass over them, but I would like to have them incorporated in the record as part of your statement.

All Main Tracks	Miles	C.N.R.	Miles	C.P.R.
Heavy Traffic (Over 1,500,000 gross ton miles)	10,500	45.1%	8,600	46.9%
Medium Traffic (Under 1,500,000 and over 250,000 gross ton miles)	7,100	30.5%	5,400	29.1%
Light Traffic (Under 250,000 gross ton miles)	5,700	24.4%	4,400	24.0%
(a)	23,300	100.0%	18,400	100.0%

(a) Includes approximately 4,000 miles entrusted to the C.N.R. for operation, the original cost of which carried no fixed charges in the railway accounts.

MR. CARSON: Now will you go ahead, please?

A. I would at this time like to make the general observation that where government agencies undertake commercial enterprises, great care should be taken to avoid the commingling of commercial operations with government costs and government subsidies. Otherwise, the accounting and financial results will be so impaired as to be meaningless or perhaps even misleading in relation either to commercial or governmental standards. This point is of particular importance in regulated industries such as railroads where part of the industry remains in the hands of investor-owned corporations because a large part of the public will use any comparisons which are favourable as a yardstick to call for the reduction of or to oppose an application for an increase in rates and

tolls for the investor-owned enterprises.

I am of the opinion that the governmental enterprise in the railway industry should be organized, in so far as possible, on a basis which will meet the following objectives -

(a) Clear segregation of the operations which are undertaken solely as a matter of government policy. The deficits from such operations should be met by specific annual appropriations by parliament. Undoubtedly the Newfoundland railway and steamship services are a good example of this type.

(b) The placing of the commercial or self-supporting part of the enterprise on a basis comparable with the investor-owned companies as to capitalization, operating expenses (including taxes and depreciation) and charges payable as an overall return on capital.

(c) The showing by the commercial part of the enterprise of the full interest cost of government funds invested. Interest on government capital should be payable if earned, should be cumulative to the extent not earned so that the government would not consider that any part of its investment has been paid back out of surplus earnings until it has received interest in full.

(d) The establishment by the regulatory bodies concerned with the operations of railways in Canada of adequate rates and tolls so that all the railways in Canada will be able to carry out the recommendations (b) and (c).

The submission of Mr. Gordon has attempted to justify the first proposal, namely the conversion of $760 million of interest-bearing obligations held by the government to equity capital by showing that, in his opinion, there is an excessive capital burden of $1,533,000,000 on various hypotheses. I have not attempted to deal with these factors as the fundamental reason for the proposal appears to me to be predicated on the claim that such an adjustment is necessary to reduce the fixed charges to a reasonable level in relation to future earnings, determined from the viewpoint of commercial standards.

If one were dealing with an investor-owned railroad in reorganization proceeding there would be merit to this contention, because the authorities would wish to assure, in so far as may be foreseen, that the reorganized company would be fully able to meet its fixed charges in the future and would perhaps wish to have enough leeway for the sale of further senior securities in the event of a future credit stringency thus avoiding recourse to further reorganization proceedings. The reorganized company would then have to strive to earn sufficient to earn its contingent interest, if any, and to show some return on the equity capital to maintain its credit standing in the financial markets.

It seems to me that the Canadian National cannot be compared with an investor-owned railroad in reorganization or bankruptcy proceedings. There is no problem of marketability because all of its debt is either held by the government or is guaranteed by the government. Further, the reorganized road is called upon to endeavour to service its equity stock for reasons stated above, whereas the C.N.R. would under the proposal have exchanged an

obligation calling for a definitive payment of interest for a type of security the servicing of which is entirely of a voluntary nature.

The principal disadvantage of the large fixed charges is claimed to be the psychological effect on officers and employees of reporting large deficits when the interest charges are not earned. This feature could be remedied by removing the "fixed" character of some portion of the charges when not earned by the use of income bonds. This method could be carried out in such a way as would show the cost to the government of supplying capital to the railway enterprise by establishing a rate of interest equal to the average annual cost of money to the government which the income bonds would be expected to earn.

The second proposal involves an immediate grant of $300,000,000 of government credit bearing interest at the rate of 3% per annum until paid in cash. The purposes for which this credit will be used are stated to be further debt reduction and capital additions to property for the next five years. To the extent that the grant represents a further conversion of debt to equity capital the comments on the first proposal apply. It should be noted that if the entire grant were so applied the funded debt of the Canadian National would be reduced to $285,000,000 or approximately 14% of the gross investment in railway properties which would compare with 34½% for the C.P.R. To the extent that the grant may be used to cover future property additions, it would seem quite unusual to request a blanket appropriation extending so far into the future. It is my belief that the result of this proposal would be a hidden subsidy in

the neighbourhood of $9,000,000 per annum granted in perpetuity. I have previously stated that, in my opinion, any subsidies should be clearly related to non-commercial type operations and that they should be specifically appropriated for by the government year by year.

The third proposal is that 40% of the cost of future development lines be provided by the government in the form of equity capital. It seems to me that a consideration of this proposal might be facilitated if we classify property expenditures into the following groups:

(1) Those which are fully justified from a commercial viewpoint and which may be expected to add earning power and therefore represent in whole or in part real additions to the Canadian National equipment and roadway property.

(2) Those which are not justified from a commercial viewpoint but which are undertaken solely as a matter of national policy.

It seems clear that those expenditures which fall within the first group represent real additions to the useful capital of the railway enterprise and there is no justification for requestingany departure from the usual method of financing a commercial transportation enterprise, which would occur if equity capital was used on which no return would be required to be paid.

In regard to the expenditures for properties which are not justified from a business or commercial viewpoint I have previously stated that any parts of the railway operations which are undertaken solely as a matter of government policy should be kept separate from the commercial transportation enterprise in order that

appropriate government subsidies may be voted to cover the deficits. It would seem to me that it would be preferable for all operations of this type to be managed for the account of the government rather than to be merged with the Canadian National system until such time as they show an earning capacity from a commercial point of view or become an integral part of the C.N.R. System when they should be merged into the accounts of the C.N.R.

The fourth proposal suggested by Mr. Gordon, covering the use of surplus earnings has, I understand, been withdrawn. The effect of this withdrawal would mean that the surplus earnings would be available and normally would be used to service the proprietor's equity but in the withdrawal of the proposal no suggestion is made that there should be a mandatory provision requiring this to be done.

Section 10 of the Capital Revision Act 1937 provides that the directors of the C.N.R. may cause to be paid over to the minister all or any part of surplus earnings. As I understand it, counsel for the Canadian National contend that this provision permits the C.N.R. to retain surplus earnings to be used for any corporate purpose but does not constitute a bar to payment of such surpluses to the government.

MR. CARSON: In case the Commission would like the reference to that, it is at pages 18948 to 18954.

THE WITNESS: In my opinion provision should be made by the issuance of income bonds or some other type of security on which a fixed interest or dividend rate is to be paid if earned so that a return on the capital invested by the government must be paid if earned.

It is my view that the effect on the C.P.R. of these proposals should be considered from both the rate making viewpoint and also the financial and competitive viewpoint.

Rate Making

(a) The effect of the first two proposals is to give over a billion dollars of interest-free capital to the Canadian National, which is equivalent to a subsidy of approximately $30 million per annum. It is proposed that this be further augmented each year in the future by the portions of property additions covered in proposal 3 and, of course, there is the further effective subsidy represented by the exemption of Canadian National from income tax.

(b) The foregoing differentials in favour of Canadian National would cause it to appear to have much more favourable earnings than the Canadian Pacific, with the result that a considerable part of the public would clamor for the use of the lesser requirements of the government enterprise as the yardstick for rate making. Such a clamor would be hard to resist because of the fallacy of having labeled as "earnings" over $30 million, which in reality would be the annual cost to the taxpayers of Canada of capital furnished to the Canadian National system.

(c) Counsel for C.N.R. has stated that the government railroad has not asked to be made the yardstick for rate making.

MR. CARSON: I think that appears in a number of places in the record, but there are two references I have here: pages 18828 and 20262-3.

THE WITNESS: It is my opinion, however, that some sections of the public will use any comparison which appear to be favourable to them in either resisting an increase or clamoring for a reduction in rates and tolls.

(d) The C.N R. in its submission, Chapter 3, page 38, states that had an adjustment of $20 million by relief of fixed charges been made effective in 1923, surpluses would have been enjoyed during the years 1925 to 1929 inclusive reaching a high of twenty-three odd million in 1928. The submission then goes on to say that "In these circumstances lower freight rates following pressure for downward revision would probably have very considerably reduced if not entirely eliminated such surpluses." This reasoning seems sound and would be equally applicable in the future as in the past.

(e) Mr. Cooper's view was that surplus earnings, previously referred to as the stabilization fund, were unlikely to reach any sizeable proportions. On the other hand, Exhibit 256 showed that had the proposals been in effect from 1940 very sizeable sums would have been accumulated and thus might have prevented the freight rate increases authorized since 1947. It seems clear to me that the effect on Canadian Pacific would be disastrous regardless of whether or not sizeable funds were accumulated. If the rate

structure is such that C.N.R. is unable to accumulate surplus earnings after an effective subsidy in excess of $30 million per annum, certainly the C.P.R. will not be able to earn a sufficient amount to enable it to remain in a sound financial condition.

These points lead one to the conclusion that the basis for rate making should be laid down by law as a reasonable return on a proper determination of property investment used and necessary to give the transportation service demanded by the public. In this case it would again be necessary to eliminate from the property investment of the C.N.R. such property as is operated from a strictly national governmental policy and on which no return should be expected, this property to be operated on an agency basis for and on behalf of the government.

Financial and Competitive

The effect of these proposals is to make available to the C.N.R.

(a) the interest which would otherwise have been payable on $760 million government owned bonds, say $21,627,000;

(b) the capital amount of $300 million equivalent to an annual subsidy of $9 million in perpetuity. The combination of (a) and (b) could be available for additions and betterments and either maintaining or improving the quality or standard of service of the C.N.R. Further it has been the history of railroads in the past in this country that there is usually some imbalance between revenues and costs and, if such remains the condition, these funds would

be available to the C.N.R. whereas the C.P.R. would be forced either to increase its funded debt to enable it to keep in a competitive position or otherwise fall behind in the race. In passing, I might point out that the $300 million is only $35 million less than the amount of the ordinary stock of the C.P.R. now outstanding.

I would refer to Section 114 of the Duff Report, 1931, which deals with the competitive aspect when one railroad is privately owned and the other backed by the long purse of the state.

"114. Had this competition existed between private companies, each dependent upon its own resources to raise the capital and to pay the bill, it is likely that years of adversity would have brought wisdom. But one of these competitors was backed by the long purse of the State, and the comsequences of these errors and extravagances must be borne by the taxpayers, and in this connection we must not lose sight of the fact that the Canadian Pacific, the principal rival of the Canadian National Railway, was at the same time the largest taxpayer. The evils of this unfortunate competition did not rest there. Challenged by the State-subsidized National System, the Canadian Pacific felt compelled, in defence of its own interests, to meet the challenge. Now in the interests of both railways and of the taxpayers of Canada there must be a cessation of aggressive and uncontrolled competition, and while the Canadian Pacific must be afforded proper protection from the State-subsidized activities of the Canadian National, it is not possible to absolve the

privately-owned company from a share in the general competitive folly."

It would be presumptuous for me to suggest that such a condition might reoccur were so large a sum to be at the disposal of the government owned railway.

The relative positions of the C.P.R. and C.N.R. resulting from the re-capitalization proposals of the C.N.R. may be demonstrated by a table attached to my statement which shows the results for the two railways for the year 1949 ifthe 20% rate increase sought by both had been in effect throughout that year and if the C.N.R. had enjoyed throughout that year the benefits of their proposals.

MR. CARSON: It might be more convenient than having those figures copied into the record if I marked the two sheets asan exhibit. They will be Exhibit 276.

COMMISSIONER INNIS: You mean they will not be in the transcript?

MR. CARSON: Unless the members of the Commission would like it in the transcript.

THE CHAIRMAN: They are more convenient, if you can have them copied into the transcript.

MR. CARSON: Then we will have them copied into the transcript. Then I need not have them marked as an exhibit.

Sheet 1

Surplus which would have resulted if a 20% Freight Rate Increase, as applied for, had been in effect for the full year 1949

Canadian Pacific Railway Company

"Total Revenue Deficiency" for 1949, (including allowances of $15,235,000 for surplus) as determined in Judgment of Board dated Feb. 28, 1950, page 14	$29,972,434
Add: Revenue derived from 8% interim increase period Oct. 11 to Dec. 31, 1949 (Judgment of Board dated Feb. 28, 1950, page 15)	2,499,266
"Total Revenue Deficiency" for 1949, (including allowance of $15,235,000 for surplus) as determined in Judgment of Board dated Feb. 28, 1950, page 15	$32,471,700
Deduct additional revenue if various other rate changes had been in effect for the full year (Judgment of Board dated Feb.28, 1950, page 15)	2,500,000
"Total Revenue Deficiency" for 1949 (including allowance of $15,235,000 for surplus) on basis of reconstructed revenue (Judgment of Board dated Feb. 28, 1950, page 15)	$29,971,700
Additional revenue if a 20% freight rate increase had been in effect for full year (20% Rate Case - C.P.R. Ex. (49)181)	28,954,422
"Total Revenue Deficiency" adjusted as above (20% Rate Case C.P.R. Ex. (49)211)	$ 1,017,278
Deduct allowance for surplus included in Total Revenue Deficiency as per Judgment of Board dated Feb. 28, 1950, page 14	15,235,000
Surplus which would have resulted	$14,217,722

Sheet 2

Surplus which would have resulted if a 20% Freight Rate Increase, as applied for, had been in effect for the full year 1949 and if the proposals of the C.N.R. had been in effect during that year

Canadian National Railways

Net Income deficit as published (Royal Commission - C.N.R. Ex. 246)		$42,043,000
Adjustments:		
Additional revenue if the 8% freight rate increase had been in effect for the full year (Royal Commission - C.N.R. Ex. 246)	$12,056,000	
Additional revenue if other rate increases (which have been authorized) had been in effect for the full year (Royal Commission - C.N.R.Ex.246)	5,837,000	
Additional revenue, on the assumption that the 8% had been 16%, and had been in effect for the full year (Royal Commission - C.N.R.Ex.246)	15,050,000	
Additional revenue, on the assumption that an additional 4% had been in effect for the full year (20% Rate Case - C.N.R. Ex. (49)212), before Board of Transport Commissioners	7,169,000	40,112,000
Deficit adjusted as above		$ 1,931,000
If interest on government loans were cancelled (Royal Commission - C.N.R. Ex. 246)		21,798,000
Interest on government indebtedness (Royal Commission - C.N.R. Ex. 246)		9,000,000
Surplus which would have resulted		$28,867,000

THE WITNESS: Sheet 1 shows the surplus which would have resulted to the C.P.R. in 1949 on the formula adopted by the Board in its judgment dated February 28, 1950, if a 20% freight rate increase had been in effect throughout the full year.

Sheet 2. shows the surplus which would have resulted to the C.N.R. in 1949 if a 20% freight rate increase had been in effect throughout the full year and if its re-capitalization proposals had been in effect throughout that year.

This table shows that the C.P.R. would have ended 1949 with a surplus of $14,218,000 which is short by $1,017,000 of the $15,235,000 held by the Board to be a proper allowance to it for surplus. On the other hand, the C.N.R. in the same circumstances would have ended the year with a surplus of $28,867,000 or approximately twice the surplus of the C.P.R.

Let us now look at the information which is available for the Commission to be able to determine as to the propriety of the proposed financial adjustments suggested by the C.N.R.

In order to gauge as to what should be the financial structure of the railroad, it would be necessary to have the following information:

1. Complete knowledge as to the gross and net investment of the C.N.R. which, as a co-ordinated whole, can be considered as required for the operation of the railroad system as a whole as distinguished from such part of the investment as may be considered as being operated for national purposes.

2. A sound appraisal of the earning power of the "commercial" lines under conditions of stabilized

costs and stabilized rates, that is to say after the imbalance between costs and rates has been corrected as nearly as possible.

3. An appraisal of the future of Canada and therefore thefuture of the C.N.R., from an economic viewpoint, that is to say from the development of natural resources and increase of population in Canada and other factors of a like character, and an attempt to show the effect of this economic future on the earning capacity of the railroad.

4. A realization of the effect of any contemplated change in the capital structure of the C.N.R. upon the financial position of the C.P.R.

The information given by the evidence of the Canadian National is, in my view, insufficient to satisfy these requirements.

CONCLUSION

I assume that the national transportation policy of Canada is to maintain a first class railroad system divided into two competing transcontinental enterprises, the one owned by the government and the other owned by investors. Such a policy, in my opinion, would be completely undermined by the adoption of the drastic subsidy proposals submitted by the C.N.R.

In regard to adjustment of capitalization of the C.N.R. I agree with the views attributed to Mr. John Barriger (on page 18536 of Mr. Cooper's testimony) that capitalization should be adjusted to the investment in the railroad enterprise after proper allowance for depreciation. Mr. Cooper has testified that the total investment in railroad properties is fairly stated and

does not require adjustment; therefore, the only adjustment required in the total capitalization of C.N.R. is to record a reasonable depreciation reserve with a corresponding reduction in the present equity capital. Such an adjustment might possibly be in the approximate range of $350,000,000 which would leave a balance of $424,000,000 of interest-free capital to apply against investment in railroad proporties operated solely as a matter of government policy. I do not know whether the latter amount is greater or less than the actual amount invested in projects of this character, but I suggest it might be used as a tentative figure in the absence of a specific dependable study.

The proposals of the C.N.R.,of course, relate more to the objective of wiping out interest charges due to the fluctuation and uncertainty of earnings of the C.N.R. In this connection I was pleased to note that the C.N.R. officials have granted that earnings of the past are not in themselves a dependable criterion or guide to earnings of the future. I fully agree with this viewpoint. Therefore, I feel that the sound approach to an appraisal of earning power is to deal with the earnings which should be produced by present and foreseeable volume of traffic in relation to present and foreseeable costs of operations. In such an appraisal: (1) the loss of Newfoundland Railways should be excluded and dealt with by separate appropriation, (2) adjustment should be made for an estimate of the rate increases which must be allowed to lessen the imbalance of increased costs incurred in the post-war period, (3) maintenance and deferred maintenance provisions should be adjusted to a normal basis, and (4) depreciation should be stated, on a proper and consistent basis in relation to the adjustment

in capitalization, and (5) any unusual charges, such as the 1949 redemption premium and amortization of discount, should be eliminated. While the foregoing comments relate to an appraisal of the earning power in the immediate future, I do not believe we should lose sight of the longer range estimates of growth in population and economic development in Canada. I have previously indicated that I am an optimist in this respect and I expect the volume of production and therefore the transportation demands to reach much higher levels in the years ahead.

The key to the problem before us, in my opinion, is the correction of rates to such an extent which will cover the substantial increases in costs of operations. If this is accomplished the earnings of C.N.R., after excluding the losses on railway lines operated for national purposes, will in my opinion meet fully the interest costs on the funded debt owned by the government and provide some returnon the equitycapital. Even so, there may be some merit in the C.N.R. request that the total fixed charges be reduced in order to provide greater flexibility and to avoid deficits in periods of reduced traffic. In my opinion this might well be accomplished by converting the indebtedness to the government, which arose through the repatriation of British securities, to income bonds. This was proposed by Mr. Vaughan on behalf of the Canadian National before the House Committee on Railways and Shipping on May 14, 1946. I have suggested this instead of suggesting the conversion of all the indebtedness to the government in order to keep the fixed pay-out requirements of the Canadian National Railways on a more comparable basis with those of the C.P.R.

My views may be summarized as follows:

1. That the imbalance between revenues and the increased costs of labour and materials should be lessened as much as possible by further freight rate increases.
2. That $391 million of interest-bearing obligations held by the government, which were issued in connection with the repatriation from the United Kingdom of C.N.R. securities, should be exchanged for income bonds in accordance with the suggestion of Mr. R. C. Vaughan and so reflected in the balance sheet.
3. That the acknowledgment of an indebtedness by the government to the C.N.R. of $300,000,000 should not be considered.
4. That future development lines, other than those created for national policy reasons should, like all other additions and betterments, be financed in the normal commercial manner, and those created for national policy reasons financed entirely at government expense and their operations segregated as a government enterprise until they become commercially sound or become an integral part of the system.
5. That a portion of surplus earnings, after paymentof interest fixed and contingent, should be retained to provide funds for improvements and betterments and the balance paid to the government as a return on its equity capital.

---The Commission adjourned at 1.00 p.m. to meet again at 2.45 p.m.

(Page 20646 follows)

AFTERNOON SESSION

MR. CARSON: I have concluded with Mr. Norman, my lord.

MR. EVANS: In answer to a question asked by your lordship just before the adjournment, I should like to speak for a moment to the quotation in Mr. Norman's statement from page 72 of the Drayton-Acworth report. I think your lordship asked this question.

THE CHAIRMAN: Will you pardon me a moment. What page is that?

MR. EVANS: At page 72; that is in the Roman numerals.

THE CHAIRMAN: What page is it here?

MR. EVANS: Page 2 of Mr. Norman's statement. I think your lordship's question was whether the report went on to give examples of these unremunerative rates. I think the answer to that question is this. They were not speaking of particular rates but rather of the principle that the enterprise which is recommended by the report and which became the Canadian National Railway should be on a remunerative basis and that if it were otherwise than on a remunerative basis, there would be rates which were unremunerative in themselves, but it would have to be supported by a subsidy. There is no indication that they had any specific rates in mind.

The second point I wanted to mention is this. I think my friend Mr. O'Donnell now agrees that his interjection that that passage referred only to the Intercolonial and the Transcontinental is perhaps not right. It applies to and is a reference to the entire system which the report would have called the Dominion Railway Company, which afterwards became the Canadian National; because on a previous page it speaks of the Dominion Railway Company, the self-contained system of 20,000 miles and in the particular paragraph with which we were dealing, and also in the preceding paragraph, it speaks of the system of which the Intercolonial

and the Transcontinental were a part or were included. I think quite obviously the quotation given by the witness referred to the entire system.

MR. O'DONNELL: I think that is possibly correct, my lord. I think one has to read the entire paragraph which has four subheadings. I just looked at the second subheading under which these words appeared.

THE CHAIRMAN: All right. Who is going to continue?

HENRY GORDON NORMAN recalled

EXAMINED BY MR. COVERT:

Q. I wanted first, Mr. Norman, to clear up a few small items in your statement. I want to make sure that I understood them. For instance, at page 5, at the top of the page, you referring to the shown by Exhibit 257 or what would have resulted, and you say:

"This latter deficit is, however, after charging as an expense $3,826,000 representing the 5% premium on bonds called for redemption in 1949 and unamortized discount thereon,..."

I wanted to ask you if you thought that should have been treated in a different manner or if you are merely pointing to that as something as extraordinary in this particular year.

A. I think in this it is just extraordinary for this particular year because it was the first year that Newfoundland Railway loss was taken up, because factually it was only nine months of this operation. And the other is an unusual item or a refinancing matter.

Q. In a refinancing matter of that kind, is it usual to take it all out in that year or, for instance, would it be amortized over a period of years?

A. I would say there are two schools of thought. One would take it off the entire year but usually it is charged off surplus in a commercial organization rather than to profits.

There is another school of thought which pro-rates it over the lifetime of the bonds which are taking the place of those which have been called.

COMMISSIONER ANGUS: Q. If you are applying uniform accounting, is that the sort of point you would expect to be dealt with?

A. Yes.

MR. COVERT: Q. At the bottom of page 6, I should like to draw your attention to the last two or three words where you say:

> " Thus it will be seen that in England, the national undertaking is required to pay a fixed return on its entire capitalization."

This perhaps has not been in a sufficiently long time to determine what happens if they cannot, but did they have a deficit in their first year?

A. In the first year, after charging the interest there was a deficit of £1,714,000; and this deficit was carried forward to the next year.

THE CHAIRMAN: Q. What figure did you give?

A. £1,714,000, my lord.

MR. COVERT: Q. Then at page 7, in the first paragraph, and you are dealing here with the question of construction of additional branch lines, you say:

> " If construction is undertaken as a means of tapping major sources of revenue then freight rates should always be at such a level so that either there would be earnings available at all times to cover the cost of such development, or such costs could be financed temporarily through borrowings with a view that ultimately the net revenues from such additional construction will be sufficient to yield a reasonable return on property investment -- "

and so on. I just wanted to get clearly from you

what you meant by this "financed temporarily".

A. So far as that is concerned, one normally in a commercial undertaking might borrow money until such time and on a basis that over a period of time proper charges for amortization of the cost would automatically put them into funds to pay this money back.

Q. You are distinguishing between "temporary financing" and what you call permanent financing?

A. That is correct; as between equity financing and borrowing.

Q. In the very next paragraph you say:

" In regard to Mr. Gordon's statement, commencing at page 18383, dealing with the effect of acquisition of unremunerative lines in national interest, there is no question in my mind but that operations such as the Newfoundland Railway and Steamship Services should be segregated and operated purely as an agency for the government and the government should meet deficits, if any, through annual appropriation. "

What I wanted to find out is what you had in mind in the long run. Are you forgetting all those except perhaps for the Newfoundland Railway and the Temiscouata, or do you think there should be a complete segregation of these so-called lines that were constructed in the national interest and that they should all be put on that management basis?

A. I would feel that,in so far as those which, as one might say, are just small branches out from the main line but which have been constructed on that basis, I do not think they would be of sufficient magnitude to justify segregation and all of the things which go with that, which would mean separate sets of accounting and inter-line arrangements and all sorts of problems. But where it is a large part and a large section of the road, I think it is of an entirely

different character and should be treated entirely separately.

Q. Who would you think would be the judge there?

A. To a great extent, I would think that the government itself is the judge of whether they have instructed the C.N.R. to take certain things over or whether they have not.

Q. Would they then be the judge as to whether or not it was to be handled in this manner?

A. No. I think then that the directors of the Canadian National should be the judge of that, having due regard to the ultimate possible feeder value and so on and so forth, and also as to the relativity of the amount that is involved.

Q. At the present time had you in mind anything else than say the Newfoundland Railway and the Temiscouata Railway? The Hudson Bay Railway is treated in that way now.

A. Mr. Covert, I do not have sufficient information in regard to the Canadian National .

THE CHAIRMAN: If I remember rightly, did not Mr. Gordon's statement contain a list of these unremunerative lines?

MR. COVERT: That is not my recollection.

THE CHAIRMAN: That is not what you have in mind.

MR. O'DONNELL: He gave a list of the lines purchased in 1929.

MR. CARSON: I think Mr. Norman just took the Newfoundland Railway as an instance, as one which he thought there was no question on.

MR. COVERT: Q. At the top of page 8 there is a comparison of the Canadian National and the Canadian Pacific, heavy, medium and light traffic density lines, and there is a note (a) there that says that the 23,300 miles of the C.N.R.:

" Includes approximately 4,000 miles entrusted to the C.N.R. for operation, the original cost of which carried no fixed charges in the railway accounts."

Would you explain that?

A. The purpose of putting that footnote there was to highlight the fact that those 4,000 miles did not in fact have any fixed charges against them at the time they were taken over.

Q. What 4,000 miles are they?

A. The 4,000 miles are made up of 2,918 of more than self-sustaining mileage, 1904 of the marginal character and 328 of the submarginal.

Q. No, that is not what I had in mind.

MR. O'DONNELL: Identify them.

MR. COVERT: Q. What I was trying to find out was this. What you have done with these 4,000 miles is that you have subdivided them into the headings of heavy, medium and light?

2 A. Yes.

Q. What I wanted to find out is if you can identify those 4,000 miles, and say from whence they came and where they are?

A. The information that I have obtained through the officials of the Canadian Pacific is that the National Transcontinental, Winnipeg to Moncton is 1,825 miles; the Barroute to Beattyville is 39 miles; Taschereau to Noranda and Rouen is 44 miles; Noranda, Rouen and Seneterre is 102 miles; Lake Superior cut-off is 30 miles; Lake Superior Branch, Superior Junction is 160 miles; Intercolonial Railway Montreal to Halifax via Levis, which includes 36 miles of trackage rights, is 863; branch lines in Prince Edward Island, 286 miles; in Nova Scotia, 445 miles; in New Brunswick, 456 miles. That totals 4,250 miles all told.

Q. What you say is that when the C.N.R. was entrusted with those lines, they brought no fixed charges into the system accounts. Is that it?

A. That is correct.

Q. Then in the next paragraph you say:

"I would at this time like to make the general observation that where government agencies undertake commercial enterprises, great care should be taken to avoid the commingling of commercial operations with government costs and government subsidies."

I just wanted to ask you about that. Perhaps that would be all right in theory, but is it practical in the case of a national railway system?

A. It is practical from the standpoint of the segregation of those things which are taken over purely for national reasons. Those would be governmental cost to the extent that they operated at a loss.

Q. It has perhaps proved practical you say in the case of the Hudson Bay Railway.

A. That is correct.

Q. And it might be practical in the case of the Newfoundland railway where it is entirely segregated?

A. That is correct.

Q. It might even be more practical there than in the case of the Hudson Bay Railway.

A. That is correct.

Q. But it would not be very practical, would it, if the line formed sort of a link between other parts of the system?

A. That would depend, I think, on the size of the link. If it was a large link, it would be practical. If it was only a small link, it would not be.

COMMISSIONER INNIS: Q. Would the management of these different sections not be appealing to the Canadian National Railway for the revision of their capital structures?

A. I think the management of that particular system would probably be the Canadian National on behalf of the

Canadian government. They would just be appealing to themselves.

Q. You say then that the Newfoundland Railway, which was placed in this position and whose accounts were always showing up in such an unfavourable way, would appeal to the Canadian National Railways for the revision of the capital structure.

A Of their own structure.

Q. Yes.

A. I would think so.

Q. There would be several to be dealt with instead of just one.

A To be dealt with because they are national institutions entirely.

Q. You break them down.

A. Yes.

(Page 20656 follows)

MR COVERT: Q. Then on the same page you go on in the next paragraph to say:

"I am of the opinion that the Government enterprise in the railway industry should be organized, insofar as possible, on a basis whcch will meet the following objectives -

(a) Clear segregation of the operations which are undertaken solely as a matter of Government policy."

Now, on that do I gather that you say the Government decides in the first instance whether they undertake the operation but that the directors of the Canadian National should decide as to whether or not it should be kept clearly segregated from the system?

A. I think a great deal of that depends, as I said before, on the quantum. If it just is going to be a few miles I do not think it is a matter of very great import, and I think every railroad is bound to have certain small mileages which are going to have deficits for the time being, and I do not think that is important; but where you build a large branch line for purely national purposes, I think it can be and I think it should be segregated.

Q. Now, I think the evidence before us was that the Canadian National submitted to the Government in the case of the Newfoundland system that it should be taken in on an agency basis; I think that is correct. Now, apparently the Government thought otherwise, and they have entrusted the Newfoundland system on the same basis as other railways, whereby the losses are taken into the system accounts. Now, what you suggest then, Mr. Norman, is really that there be a statute that says in that case that the Canadian National directors should really be able to insist that they not be taken into the system?

A. Yes. Of course, as I say, far be it from me to put myself up as disagreeing with the Government's policy, but I am merely expressing a view as to how one would normally account for these things, as an agency rather than as an owner.

Q. What you are in effect trying to do here is to put the Canadian National on certainly a nearly commercial basis; is that correct?

A. That is correct.

Q. And then under item (b) which follows at the bottom of page 8 and goes on to page 9, you say:

> "The placing of the commercial or self-supporting part of the enterprise on a basis comparable with the investor-owned companies as to capitalization, operating expenses (including taxes and depreciation) . . ."

By taxes there do you mean income taxes as well?

A. Income taxes, yes.

Q. . . ."and charges payable as an overall return on capital."

Now, I wanted to ask you as a practical man whether you thought that a thing like that could be done, to, for instance, insist that the Canadian National pay income taxes?

A. That would be entirely, sir, as a matter of Government policy, I would think, rather than from a practical policy.

Q. Well, if you look at the publicly-owned utilities throughout Canada, do you find any of them in that position?

A. You find---

Q. The publicly-owned utilities -- for instance, the municipally-owned electric and telephone utilities, the municipally- or provincially-owned, or any of the Dominion-owned companies -- do you find them in that position, where

they pay taxes?

A. What we know as Crown companies?

Q. Yes.

A. No, they do not pay taxes.

Q. What I am asking is, do you find any situation similar to what is suggested here? That is why I am asking you whether you thought as a practical matter the public would stand for it?

A. Well, in answer to that I would say I think there is only one situation where you have got two large railroads to compare one with the other. You have got the situation so far as normal public utilities are concerned, and whether they be electric light and power companies or others, you have publicly-owned companies, but also have a large number, a very large number, of private investor owned companies, whose rates can be measured one against the other, and they are not dependent upon measuring rates against the results of the publicly-owned Crown companies -- entirely.

Q. Well, I may be wrong, but I think we heard Mr. Frawley protest very vigorously at the thought of the Canadian National paying income tax, and what I am suggesting is that that might be the situation throughout the country; they would just say, "Well, that is really one method of getting rid of some surplus they have, the railways"?

A. Well, if you do not pay income tax you are transferring to one group of citizens the cost which should be borne by the other.

Q. Well, you think there would be no difficulty, I gather?

A. I think there would be considerable outcry, but that still does not do away with the theoretical fact that I think it is desirable.

Q. Then in the second paragraph, that is (c) on page 9, you say:

"The showing by the commercial part of the enterprise of the full interest cost of Government funds invested. Interest on Government capital should be payable if earned, should be cumulative to the extent not earned so that the Government would not consider that any part of its investment has been paid back out of surplus earnings until it has received interest in full."

Would that be putting them back somewhat in the position that they were before the 1937 Recapitalization Act?

A. In part, but not entirely. It would be putting them into the position where they keep a record without of necessity showing the obligation in their accounts as such annually, but they would keep a record of the amount of that cumulation.

Q. Now, it just seemed to me, Mr. Norman -- and I would like your views on it -- that the combined result of (a), (b) and (c), omitting (d) for the moment, was to really say that here this Government-owned railway should be put as nearly as possible on a commercial basis, so that you can more properly gauge the result of its operations with its competitor?

A. Well, I would not put it so much from the standpoint of gauging its results. I think it is more from the standpoint that if its results are going to be taken into consideration in deciding what is the proper rate of freight and toll that should be charged, its results should be of a comparable nature.

Q. Does the root of any recapitalization -- is that affected by your items (a), (b) and (c)?

A. Well, I think the suggestion that $760 million be

turned into equity capital---

THE CHAIRMAN: Q. Would you please repeat that? What do you say about that suggestion?

A. The suggestion that $760 million of funded debt be turned into equity capital has a very definite bearing on (a), (b) and (c), because you are turning something which has a fixed obligation into something where it is a purely voluntary obligation, not even involuntary to the extent that if it is earned. At that point I would like to refer to the fact that there is about a billion dollars of income bonds presently outstanding in the United States railroads -- $1,046 million -- many of which have this cumulative feature.

COMMISSIONER INNIS: Q. Did you say none of them have this?

A. No, I say many of them; practically most of them have. The cumulative features vary. In some cases they are cumulative up to 13½ per cent, some up to 18 per cent, and some fully cumulative; I will say the less number is fully cumulative. But it is a recognized proceeding in so far as commercial concerns are concerned.

Q. You would not worry about expressions of political views in the regions which are concerned? I think we had some evidence in the Maritimes that they disliked this idea of separated accounts showing a deficit, because it clearly reflects on the whole position of the community?

A. Are you speaking now, sir, with regard to segregation of nationally operated lines?

Q. I am thinking of this general proposal that you are putting forward.

A. No, I don't think so.

MR COVERT: Q. Perhaps I could put it this way to you, Mr. Norman: It has been suggested, I think, that the

people in the Maritimes do not like to have shown the deficit that the Intercolonial or the I.C.R. suffers, and that if that could be hidden in the general pot they would perhaps like it better. I think Dr. Innis' question is, wouldn't you receive the same kind of representations say from the Newfoundland system or any system that is set---

A. I think that is quite possible, yes, I think that is quite possible.

COMMISSIONER INNIS: Q. That does not worry you particularly?

. No.

MR O'DONNELL: Not from the Windsor Street point of view.

THE WITNESS: Not a bit.

MR COVERT: Q. Now, at the top of page 10, Mr. Norman, you say:

> "It seems to me that the Canadian National cannot be compared with an investor-owned railroad in reorganization or bankruptcy proceedings. There is no problem of marketability because all of its debt is either held by the Government or is guaranteed by the Government."

I just wondered if you thought that there were any inconsistencies or any need of reconciliation between that and the item (b) at the bottom of page 8, where you had discussed putting it on a commercial or self-supporting basis?

A. No, I think, Mr. Covert, if you look at the bottom of page 9, I deal with the fact of what would happen in reorganization proceedings of an investor-owned railroad.

Q. That is right.

A. Then I bring out the fact that you cannot compare that with the Canadian National, because they have not got

the same problems. They have, I won't say free money, but they have money available to them, and the privately-owned railway does not; it has got to go out and get that money.

Q. I just thought that in effect you do on the one hand say that they cannot be compared?

A. From that point of view.

Q. It was just from that point of view?

A. Yes.

Q. The reorganization point of view?

A. Yes.

Q. And I suppose that that lack of comparison perhaps seeps through the whole discussion as to what the re-capitalization of the Canadian National should be?

A. I think you are right.

Q. Now, on page 11, in the first full paragraph there, the third proposal, you are discussing there the 40 per cent of the cost of future development lines, and you divide them into two groups. Have you found the place?

A. Yes, I have it, sir.

Q. You say:

"(1) Those which are fully justified from a commercial viewpoint and which may be expected to add earning power and therefore represent in whole or in part real additions to the Canadian National equipment and roadway property.

(2) Those which are not justified from a commercial viewpoint but which are undertaken solely as a matter of National policy."

Now, again I wanted to find out, who would decide whether it is a commercial proposition and whether you thought the Canadian National directors should have the decision -- perhaps not just a decision, but the right to decide whether or not they will operate a line on a particular basis?

A. Well, I would think first of all that that would have to be in some degree measured by whether or not they got direction from the Government in the first place. If they get direction from the Government, then I would imagine that their statistical section and their engineers and other appropriate people will figure out whether or no it is of commercial value or whether it is purely of national value, and I think they must be the final deciders as to whether it does have commercial value or not.

Q. And you say then if it is of commercial value, which the statisticians and accountants and so on of the railway will determine, then in that case you say there is no justification for requesting any departure from the usual method of financing?

A. That is correct.

Q. Now, by the usual method of financing, I first wanted to find out just what you mean?

A. The usual method of financing, from the commercial viewpoint, is that you may have a certain amount of earnings which are retained earnings which are available for the purpose of expansion, and those are used. Then you may get further moneys towards this construction by borrowing money. Those are the two normal methods of financing of further expansion. And the third way would be to go out and get brand-new money of an equity nature and pay for it.

Q. In which case you would expect a return on it?

A. Well, I certainly would not expect to go out for a commercial enterprise and borrow money and tell somebody I am not going to pay him anything.

Q. Now, I put it this way to you, that if the C.N.R. were to make the decisions as to whether or not they viewed it from a commercial viewpoint, or say it was justfied

from a commercial viewpoint, if they were to make that decision, and if they had the possibility of securing capital on the basis that is suggested in the proposal, they would be unlikely to ever decide that this had commercial possibilities?

A. If they had the possibility of getting 40 per cent free?

Q. Yes.

A. I would think they would consider quite a few of them from a commercial viewpoint, because they do not have to make any return on 40 per cent of their investment.

Q. The proposal to which you refer there, Mr. Norman, is number three, is it, that future development lines should be financed to the extent of not more than 60 per cent by interest-bearing securities, the balance to be supplied by the Government against the issue by Canadian National of a commensurate amount of equity stock?

A. That is right.

THE CHAIRMAN: Pardon me. Does that refer -- it seems to, as you read it -- exclusively to lines to be built?

MR COVERT: Yes, future development lines.

THE CHAIRMAN: Not to lines to be taken over.

MR COVERT: That is right.

THE CHAIRMAN: Unremunerative lines and so on.

MR COVERT: No; this is purely future development lines. Now, Mr. Norman has divided those into two classes, one class fully justified from a commercial viewpoint and the other which are not justified from a commercial viewpoint.

THE CHAIRMAN: Might you say that that may be the two classes which Mr. Gordon had in mind when he said what he did say there?

MR COVERT: It might be.

THE CHAIRMAN: That the company would remain free

either to act or not to act.

MR COVERT: That is right, Mr. Chairman; it might well be.

COMMISSIONER INNIS: Q. Could you draw a sharper line, and say that everything that is going to lose is a matter of national policy?

A. No, sir, I would not say that. Anything might lose very readily for one or two years. Many commercial enterprises will spend considerable sums of money, but they don't expect to get a return on the day that they spend it. It may lose money for two or three years, but the ultimate results might far offset the loss of return for that period.

Q. Then everything that is going to lose permanently is a matter of national policy?

A. Well, I won't say permanently, but for a long period, until, if it is a case of a railway taken over, it has had an opportunity to be rehabilitated.

Q. It would seem to me very difficult for the Canadian National to draw the line, when there was a prospect of having to operate say at 5 per cent from a commercial point of view and 3 per cent from a national point of view?

A. Well, sir, as I understand one of the comments of Mr. Fairweather in connection with this, it was that this to some extent was needed on account of the higher cost, and there was a suggestion I think made that there should be some form of a subsidy, which I assume this 40 per cent is looked upon as. Now, if you are going to have a subsidy on account of higher costs of development lines, it seems to me that a similar subsidy should be given to the C.P.R. if they are going to build development lines.

MR COVERT: The C.P.R. does not want subsidies, Mr. Norman.

THE WITNESS: I am merely expressing my view, not

necessarily the C.P.R.'s view, but I do not think you could treat one one way and one the other.

COMMISSIONER ANGUS: Q. If a mistake were made in the classification, would you correct it, in the light of experience? I mean, if a railway were classified as fully justified and turned out not to be fully justified.

A. No; I think that the risk is taken at the time, like any other commercial enterprise. I think you take that risk and you stand by it. If you lose you lose. I do not think you can have two bites at the same cherry.

COMMISSIONER INNIS: Q. The fact that the Government is there to catch the ball might mean that the Canadian National would take a rather conservative view of it?

A. I agree with you there, sir.

MR COVERT: Q. That is what I was suggesting, Mr. Norman, that in the one case they do have a 60 per cent funded debt; wasn't that correct, under their proposal?

A. That is correct.

Q. In the other case the Government would take it over and they would have no funded debt, and if the thing operated at a deficit it would not be shown in the system accounts?

A. Until such time as it would either get itself on a commercial basis or until such time as it becomes an integral part and a feeder to the system as a whole and justifies that change.

THE CHAIRMAN: Q. I wonder whether this suggestion could be applied on other railways equally as well as it might be applied to the Newfoundland Railway and to the Hudson Bay Railway, which stand off apart by themselves. Could you cut all the other railways up that way

and run them on this same system?

A. No, sir. My lord, I do not think that is my intention or my thinking. My thinking is that in one case you have got a suggestion that they are going to build development lines assumedly and they want to get a certain amount of that capital. Now, if those development lines are going into a section of the country in the same way as I think the line was built in to Noranda some little while ago -- and certainly no one can deny that that was probably a commercial line built for the purpose of opening up that section; I do not know whether it pays or not.

Q. Well, I must confess that I did not have altogether in mind your present proposal; I had the more general proposal of yours about the segregation of these lines which are unremunerative, risky, to remain Government lines under the agency or management and operation of the Canadian National Railways. That is your general proposal?

A. Yes; those which were taken over---

Q. I beg your pardon?

A. Those which were taken over, my lord, as a national policy.

Q. Well, that policy can be applied and is being applied to the Hudson Bay Railway, and I can conceive of it being applied easily to the Newfoundland Railway or even to the Prince Edward Island Railway; they are all off by themselves.

A. Yes.

Q. And easily accounted for. Could you apply this system of yours with the same facility to the other lines that have been taken over?

A. Not if they become a part of the system itself.

Q. I mean, are there not some of them so situated that they do become---

A. I agree with that, my lord, yes.

MR O'DONNELL: As I understand it, Mr. Norman's proposal is really another method of doing what Mr. Gordon's plan proposes, with this, that the segregation of these lines, as I understand it, is counter to Government policy in most cases, as it is at the present time.

THE CHAIRMAN: Probably for the reasons I have been given there.

MR O'DONNELL: Yes.

THE CHAIRMAN: Except in the case of the Newfoundland Railway, which is not susceptible to those reasons, because it does stand off by itself in a way, and might, it seems to me, be handled as an agency commitment rather than as an integral part of the system.

THE WITNESS: Yes.

MR COVERT: Q. Then on page 12, Mr. Norman, in the third paragraph down, you say:

> "In my opinion provision should be made by the issuance of income bonds or some other type of security on which a fixed interest or dividend rate is to be paid if earned so that a return on the capital invested by the Government must be paid if earned."

Now, I wanted to find out first if you had in mind that all of the present equity capital as well or just the fixed debt which might be converted into equity capital would be put on the income?

A. I am speaking now of the proposed change from funded debt to equity capital, and also these 40 per cent additions and the $300 million.

Q. I see. Then you mean, for instance, if financing were done of these so-called development lines where 60 per cent was advanced in the form of bonds and 40 per cent

equity capital, that 40 per cent would also be in the nature of income bonds?

A. Either income bonds or some capital which had some fixed rate of return.

Q. Payable if earned?

A. Payable if earned.

Q. And in that connection would you add to this paragraph that that should be on a cumulative basis?

A. I think there might be a limitation to the cumulation, because there is no purpose in building up too great a millstone to hang around the neck, if the millstone is there.

MR DONNELL: Another Capital Revision Act of 1937.

THE WITNESS: That is what it would call for, if you did not have the cut-off.

MR CARSON: What did you say, Mr. O'Donnell?

MR O'DONNELL: It would require another Capital Revision Act of 1937 to deal with the deficit.

THE WITNESS: You would not be dealing, Mr. O'Donnell -- if I am supposed to answer you -- with a deficit at all, because you would not have one.

MR O'DONNELL: That is, on your theory?

A. On my theory.

MR COVERT: Then on page 14, Mr. Norman, I wanted to deal with that paragraph just about in the middle of the page:

> "These points lead one to the conclusion that the basis for rate making should be laid down by law as a reasonable return on a proper determination of property investment used and necessary to give the transportation service demanded by the public."

Now, I wanted to know first if you are suggesting there that a valuation should be made to determine a rate base

for both railways?

A. Yes.

Q. Then I wanted to ask you in that connection if you thought that that would give to the Canadian Pacific the protection which it seems to feel that it requires; if the Canadian National as a result of that had surpluses, would not the pressure still develop?

A. That is quite possible, yes, but as a basis for determining a rate I consider that the return on investment, having in mind these surpluses which may be accumulated, would be better than merely comparing the requirements of the C.N.R.

Q. Would you put it this way, that perhaps it means that the Canadian Pacific is prepared to take its chances in competition if they are both on a reasonable rate base?

A. Well, I think you would have to ask the Canadian Pacific officials, not me. I cannot speak for them.

COMMISSIONER ANGUS: Q. For the purpose of a rate base is your proposal that specific property should either be in or out? I mean, there is no question of taking something in at half its value or something of that sort?

A. You mean in so far, Mr. Angus, as the segregation of the non-commercial from the commercial is concerned?

Q. Yes.

A. No, I do not think you can be half in, half out. I think you might have a middle lane there, where you might have one which is partially commercial and partially Government, in which case I think that the problem, if it is a problem, of building a line, should be met by a subsidy, and clearly so stated.

Q. You were not considering the possibility of saying, here, we have a property that if it were all in would go in at $5 million, but in view of its low earning power we will

put it in at $3 million -- that sort of thing?

A. No, I was not visualizing that at all, sir.

MR COVERT: Q. At the bottom of page 16, I just wanted to make sure that I understood what you meant. You say:

"In order to gauge as to what should be the financial structure of the railroad, it would be necessary to have the following information:"

Now, in 1, I take it that what you are saying there is, you should endeavour to determine what we might call the intrinsic value of the property; is that correct?

A. Hardly the intrinsic value; I would say the factual cost value less depreciation up to date.

Q. You say the---

A. The factual cost less depreciation to date.

MR O'DONNELL: A going concern.

MR COVERT: Q. You say:

" . . . as a whole as distinguished from such part of the investment as may be considered as being operated for national purposes."

You mean---

THE CHAIRMAN: Q. Does that simply mean at a loss?

A. Not necessarily, my lord.

Q. Because the whole system of the Canadian National is established for national purposes.

A. Well, I think both the railways are established for national purposes.

Q. Yes.

A. I mean those which have been---

Q. When you say "such part of the investment as may be considered as being operated for national purposes", would you give another description to that so we will understand it?

A. Well, it is a railroad such as the one which has just

been taken over, this Newfoundland Railway. One could say, being taken over -- being operated for national purposes at -- being taken over, rather, at the requirement of the Government and operated for their account.

Q. Well, that railway, if it should turn out or if it should be the case now that instead of being operated at a loss it was operating at a profit, would you still classify it as a railway operated for national purposes?

A. Not of necessity, sir.

Q. I see. Then when you do qualify "railway" with that language, you mean one which is bound to run at a loss?

A. That is correct, sir.

Q. But which in the public interest must run?

A. That is correct, sir.

MR COVERT: I wanted to find out first, when you refer to the C.N.R., you are referring to the C.N. system?

A. That is correct.

Q. Including Government Railways?

A. You mean the old Canadian Government Railways?

Q. Yes.

A. Yes.

Q. But what you would apparently do is to eliminate from that investment such of these as operate for the national purposes in the way in which you have just defined them?

A. That is correct; such as those which are indicated maybe by Mr. Gordon. I do not know whether they are all of that same character or not.

Q. Then in item 2 it is earning power that you are dealing with, isn't it?

A. That is correct.

Q. Item 3, you refer to an appraisal of the future of Canada and therefore the future of the C.N.R.; that is really

a guess, perhaps based on experience?

A. It is a guess based on experience, which I think most people make before they start embarking on a large programme of expending money. For instance, I would like to suggest to you that if in a commercial business -- I know one which we are closely connected with -- there was a programme made to spend over a period of five years $150 million, and there was a very, very complete forecast made as to the future earnings which were going to arise from that expenditure, and when it was going to come about, and they had to do certain banking facilities, and the bankers would never have listened to them unless they had made these forecasts. I am merely saying here that in order that you can go to your banker, who is the Government, and say, "Here, I want to change my bonds for something else," if I were the banker I would say, "Well, I want to see a forecast of what all this is about. If we do this, what is the answer?" And you would have to take into consideration a possible change in the economic situation of the country, the growth of the population, the possible savings that can be made by doing certain things, and everything of that character.

Q. I just wanted to clear that up, Mr. Norman. In other words, people do in effect predict the future, I suppose, every time they start an enterprise?

A. Surely, naturally.

Q. And the original prospectus of most companies is based on---

A. On prediction.

Q. ---the tonnage they will be able to sell if they---

A. That is right.

Q. That is what you have in mind there?

A. That is right.

Q. Some reasonable forecast of the future based on what information at least you can obtain?

A. That is correct.

Q. Then item 4 is perhaps, as far as you are concerned, the crux of the situation -- the effect that it may have on the C.P.?

A. That is correct.

Q. Now, you say that we have not got 1 -- that is, we have not any evidence as to the cost less depreciation to date of the Canadian National System?

A. So far as I am aware from the evidence.

Q. And you say we have no sound appraisal of the earning power of the commercial lines of that system?

A. I have not seen any forecast of it.

Q. And you say that we have not an appraisal of the future of Canada and the future of the C.N. from an economic viewpoint?

A. Not expressed in dollars at all.

Q. Do you say that they have not presented to us a realization of the effect of this contemplated change in the financial position of the C.P.R.?

A. Well, number 4, I would think that you will have that in due course.

MR CARSON: You said "they" had not presented it.

MR COVERT: Q. What you are saying is that the C.P.R. witnesses are presenting that now?

A. That is correct.

MR O'DONNELL: We had always assumed that they were capable of taking care of themselves.

MR COVERT: Q. At the bottom of page 17 you give figures; you say, I think, after having arrived at the conclusion that the only adjustment required woudd be depreciation reserve, with a corresponding reduction in the

present equity capital, then you present two figures. You say:

"Such an adjustment might possibly be in the approximate range of $350,0d0,000 . . ."

I wondered how you arrived at that?

A. Well, that was arrived at in a very approximate manner by trying to relate the reserve of depreciation which the Canadian Pacific has in relation to which property, and taking somewhat of a similar approximation with regard to the investment in railroad of the C.N.R. As I say, here I have no knowledge as to whether the figure is correct or is not correct.

Q. It might be out a good deal?

A. Well, I think that if you look at the C.N.R. report, on a property of approximately $2 million---

Q. $2 billion?

A. $2 billion, that you have an accrued depreciation of $150,000. From our normal commercial viewpoint it does not look very much.

Q. 350---

A. 125 plus 25, isn't it?

MR EVANS: Q. Thousand or million?

A. $150 million, I should say; I beg your pardon; which is roughly 6½ per cent.

MR COVERT: Q. And $350 million would be what? About 17½ per cent?

A. 350 plus 150 would bring it up to half a billion, which would be roughly 25 per cent.

Q. This would be $350 additional?

A. That is correct, yes.

Q. And that would be, you say, about 25 per cent. What is the situation with the Canadian Pacific?

A. Depreciation reserves, Canadian Pacific, December

31, 1949, aggregated $464 million as compared with -- that covers all of their property; I have not got the exact figure here on the railroad -- as compared with $1,381 million.

Q. $1,381 million?

A. $1,381 million. I can give you that, sir, with regard to railway. Railway is $384 million as compared to $1,200 million, which is roughly---

Q. 32 per cent?

A. About 32 per cent.

Q. Then from there you have proceeded to give us another figure; you say, which would leave a balance of $424 million of interest-free capital. You have deducted the $350 million---

A. I have deducted the $350 million, Mr. Covert, from the---

Q. From the equity capital?

A. From the equity capital.

Q. Then on page 18, when you say that might be used as a tentative figure in the absence of a specific dependable study, you mean that that is tentative figure for re-capitalization pending a real studied survey?

A. That is correct.

Q. Now, on page 19 in the middle of the page you say: "I have suggested this instead of suggesting the conversion of all the indebtedness to the Government in order to keep the fixed pay-out requirements of the Canadian National Railways on a more comparable basis with those of the C.P.R."

Now, I wondered if you could give us what you would say are the pay-out requirements of the C.N.R. and the C.P.R.?

A. Well, the fixed charges of the C.P.R. plus its income taxes amount to in all some $32 million, and the fixed

[illegible] $[illegible] million as compared with -- that [illegible] all of that property; I do not get the exact [illegible] figure on the [illegible] compared with $[illegible].

[illegible]

A. $[illegible] million. I can give you that, sir, in [illegible]. Railway is [illegible] million as compared to $[illegible] million, which is [illegible].

[illegible]

[illegible] cent.

[illegible] Now from those figures you have [illegible] to you, as [illegible] you now, which would leave a balance of [illegible] million of internal-[illegible] capital. You have [illegible]

[illegible] we remember the $300 million, Mr. Gavert, from the [illegible]

[illegible] from the equity capital?

[illegible]

[illegible] Yes, sir. When you say that it ought to be [illegible] a [illegible] figure in the neighbourhood of [illegible] [illegible] should you go a step further in [illegible] [illegible] for [illegible]

[illegible]

A. That is correct.

Q. Now, on page 10 in the middle of the [illegible] you say: "[illegible] suggested that instead of a [illegible] [illegible] of all the [illegible] to [illegible] [illegible] to loan the fixed [illegible] [illegible] National Railways on a [illegible] basis of the C.P.R."

Now, I wondered if you could give us what [illegible] the [illegible] requirements of the C.N.R. [illegible]?

A. $[illegible], the fixed charges of the [illegible] income taxes amount to in all some $39 million [illegible]

charges of the C.N.R. after the conversion of the $391 million would be $32,641,000.

Q. The fixed charges of the C.P.?

A. The fixed charges of the C.P.

Q. That is including income -- and plus income tax?

A. The fixed charges after deducting what is allocated as non-rail under the Board's decision would be approximately $13 million. Income taxes would be approximately $19 million, so that gives them $32 million. The fixed charges of the C.N.R. after the conversion are $391 million, which would be approximately $32,641,000.

Q. Now, are those what you call pay-out requirements, paying out requirements on a comparable basis?

A. At that stage. Then in addition to that one would naturally add the normal dividend requirements of the C.P.R., which are $21 million, and what has been laid down by the Board as their requirements for surplus of $15 million, which would come to $68 million, or which would be equivalent to or be greater than the further requirements on the income bonds of the C.N.R. of $13.7 million, plus a surplus, whatever may be deemed to be right and proper. I put down the same figure as the Canadian Pacific of $15 million, which would give you $61 million. But if it is decided you are entitled to more because of the size of the railroad, which might be quite reasonable and natural, you might probably get the $68 million, equivalent to the $68 million. But the moneys that have to be paid as fixed charges by the C.N.R. at that stage would be equivalent to that which has to be paid by the C.P.R. in the form of fixed charges and income taxes.

Q. How would you think, Mr. Norman, that it should be covered -- and I think you cover that in item 5 on page 20:

"That a portion of surplus earnings, after payment

of interest fixed and contingent, should be retained to provide funds for improvements and betterments and the balance paid to the Government as a return on its equity capital."

What would you think would be a proper test for deciding how much surplus earnings should be retained?

A. I think it should be some relation to the gross revenues of the enterprise.

THE CHAIRMAN:Q.Of the what?

A. Of the gross revenues of the enterprise.

Q. You said some relation?

A. Some relation, yes.

MR COVERT: Q. Now, is there a fair yardstick, Mr. Norman, for determining that relation?

A. Well, I know of no yardstick for determining that. As was mentioned this morning by Mr. Northey Jones, in commercial enterprises the usual thing is, you keep half and pay out half.

THE CHAIRMAN: Q. Pardon me a moment. Do you mean that you keep half for improvements and betterments?

A. You keep half for improvements and betterments, and pay out half as a service of your equity capital. I think, too, it should be borne in mind that in that respect in so far as the C.P.R. is concerned it is not in the same position and would not be as the C.N.R., because they have to have money to come and go on, in view of the fact that if they have a deficit they have got to pick it up the next year, whereas in the case of the C.N.R. as it is constituted today they have a deficit and it is picked up for them.

MR COVERT: Q. I have just one more point I want to deal with, Mr. Norman. You have, I think, shown by your statement a fear from perhaps two quarters that recapitalization of the Canadian National would affect the Canadian

Pacific; now, whether it would or might, the possibility is there; that is what in effect you say?

A. That is correct.

Q. And you say that the Canadian Pacific should be protected from that, and I think perhaps you quote from the Drayton-Acworth Commission and the Duff Commission to indicate that they recognized at that time that when you had a private company competing with a Government-owned one perhaps the private one may need protection?

A. That is right.

Q. Now, that involves the question, of course -- it is on the basis, we should say, that the Canadian Pacific is to continue as a private enterprise?

A. Yes; on that basis, yes.

Q. And in effect you say that they must always be the yardstick?

A. No, sir, I have not said that.

Q. You do not go that far?

A. I have not said that; I have not gone that far.

Q. You do not say they must be the yardstick for rate-making purposes?

A. I have not said that.

Q. All you say, then, is that they must be protected to the extent that they can earn a fair return on their property investment?

A. That is correct. Probably I could express one of my fears that I have -- I am now speaking purely in my personal capacity.

Q. Yes?

A. That I have, and that is that the time may come when we may get into a depression.

THE CHAIRMAN: Q. When you might what?

A. We may get into a depression, and when that time

may come, if the Government-owned railroad has available to it sums of money with which it can keep its maintenance up to we will say the top-notch condition, and in addition can also proceed with additions and betterments and the purchase of equipment, whereas in the case of the privately-owned railroad they, having to bear their own deficits out of their own moneys, and possibly being unable to finance sufficiently easily, the might be unable to maintain on a competitive basis, and I think that was one of the fears, as I read into it, that was expressed both in the Duff Report and in the Acworth Report.

MR COVERT: Q. What I was coming to was, ordinarily if a company wants to reorganize its capital, I suppose no one else has a right to complain?

A. None at all, none at all.

Q. But what you say is that there is a difference when that reorganization is of a Government-owned company?

A. That is correct.

Q. And what you say is that if by that recapitalization it may affect the ability of the other one to carry on, then the recapitalization must be accompanied by some safeguards?

A. Correct; because the actual recapitalization as such is not a sole recapitalization; it is a recapitalization to the extent of $760 million, and it is the granting of a grant of $300 million, which is I would say a rather novel form of recapitalization, and also a perpetual subsidy.

Q. Well, to carry the matter to the extreme, suppose they had come forward with the proposal that all of the bonded indebtedness should be wiped out, it should all be equity capital, and that instead of asking for $300 million they had asked for $500 million?

A. I would say it was purely that much of a degree worse, so far as the effect on the C.P.R. is concerned.

Q. Then would you say that in that case the effect would be that they could have larger surpluses?

A. Yes, definitely.

Q. And then carrying it the other way, suppose they had only asked for a reduction of their funded indebtedness by $100 million, then perhaps the Canadian Pacific would not be even interested in the recapitalization?

A. I do not think they would be very seriously interested. I think naturally they would quite possibly feel that that money should be called upon to earn a return and that the return if earned should be paid.

Q. Then doesn't it really boil down to this, Mr. Norman, that it is the possibility of a surplus, the possibility of a surplus in the Canadian National, which may bring about pressure either on rates or which perhaps you go further and say will not really show what the true -- this recapitalization may leave the Canadian National that it will not really show what the cost of operating the railroad is?

A. That is correct; but I think inaddition to what you have stated there is a further factor to be taken into consideration, that there will be available to the Government-owned railroad some $300 million to more or less spend as it may see fit, and not have to earn anything thereon.

Q. And under the proposal to add branch lines on the basis of 60 per cent supplied by bonds and 40 per cent by equity capital, perhaps more than $300 million?

A. You have just got that additional amount, yes.

Q. Those are the things that you say we need complete information on before we could decide one way or the other as to recapitalization?

A. That, and the other appraisals as to the future earning power evaluated as suggested, based on future economic conditions and so on.

Q. Thank you.

(Recess)

MR SHEPARD: Mr. Chairman, I have relatively few questions to ask Mr. Norman.

CROSS-EXAMINED BY MR SHEPARD:

Q. First, Mr. Norman, I would like you to turn to page 6 of your statement, at the bottom of the page. Mr. Covert asked you one question about the last sentence on the page, which reads:

> "Thus it will be seen that in England, the national undertaking is required to pay a fixed return on its entire capitalization."

And then further up in the paragraph you name the figure on which under statute a fixed rate of interest of 3 per cent is now required to be paid. My understanding is that that figure of £1,131 million odd ---

THE CHAIRMAN: I beg your pardon, would you please repeat that?

MR SHEPARD: Q. My understanding is that the figure shown in that last paragraph on page 6 of £1,131 million odd is the gross market value of the railway securities as at the day of expropriation in England for nationalization; is that your understanding, Mr. Norman?

A. It is not the market value; it is the actual par value of the securities which were issued.

Q. There was a par value?

A. Of the securities issued.

Q. Of the securities issued?

A. Right.

Q. As at the date of expropriation?

A. That is correct.

THE CHAIRMAN: The outstanding securities.

MR SHEPARD: Yes, sir.

THE CHAIRMAN: At the time of expropriation.

MR SHEPARD: Yes.

THE WITNESS: The price paid for the shares of the constituent companies was the market value of the shares of those constituent companies on a given date.

MR SHEPARD: Q. But the price is not this figure?

A. The price is this figure, 1,131 million; that is the obligation of the Transport Commission.

Q. I was going to suggest, and I think probably you will agree, that the reason that that bears a fixed interest rate of 3 per cent is that in fact the British Government had to borrow that money in order to pay off the existing security holders?

A. I am afraid I cannot impute motives to the British Government. I do not know.

Q. But the fact is that the British Government did pay off the existing security holders when they expropriated the securities?

A. Correct.

Q. Then the fact also is now that under the British scheme it amounts to a 3 per cent return on capitalization rather than value of assets used and useful in the railway enterprise?

A. Not entirely. At the time when this transaction took place they took over and set up on their books all of the various assets and liabilities other than the capital liabilities, and after having done that and taken them up

at the same figures, there was an adjustment account of some -- just a second and I will tell you the figure -- £157 million.

Q. That was an adjustment for the difference between value of securities and physical value of assets?

A. I do not say physical value, but assets of a physical nature and tangible nature, less the current liabilities.

Q. Less the current liabilities?

A. That is right.

Q. And those were book values then, I take it; is that so?

A. They were book values to the best of my knowledge.

Q. In any event, the figure shown on page 6 of your statement is not related directly to the value of physical assets used and useful in railway enterprise in England?

A. I will put it this way, that the £1,131 million is not a valuation of the assets.

Q. Then would you turn to page 11 of your statement, Mr. Norman, at the top of the page, the first complete sentence at the top of the page, which reads :

"I have previously stated that, in my opinion," -- and I think that previous statement is found on page 8 of your statement --

"any subsidies should be clearly related to non-commercial type operations and that they should be specifically appropriated for by the Government year by year."

Now, I wanted first of all to confirm my understanding of what you mean by non-commercial. I think on page 8 you refer to it as being non-self-supporting?

A. Non-self-supporting and taken over -- or, rather,

either constructed or taken over at Government instructions.

THE CHAIRMAN: Q. By non-commercial you mean non-self-supporting?

A. Non-self-supporting and taken over on Government instructions.

MR SHEPARD: Q. I was wondering, Mr. Norman, whether you would have any views on what might be termed non-self-supporting classes of traffic as opposed to non-self-supporting lines of railway, whether they should be handled in the same way, by subsidy? Perhaps I should go on, just to let you know exactly what I have in mind. I am thinking of passenger service just as an example. If passenger service for the Canadian National, or the Canadian Pacific for that matter, could be demonstrated to be non-self-supporting, would you consider that it should be a matter for subsidy, as you have suggested here?

A. No, I do not think so.

(Page 20696 follows)

Q. You differentiate entirely between lines of railway and classes of traffic, from a self-supporting standpoint?

A. I think you have to take the enterprise as a whole. When you deal with a railroad, you know you are going to carry passengers and you know you are going to carry freight traffic. I do not think you can chop it up and say we will have so much of our capital represented by the passenger traffic and we will not have to pay any dividends on it, and we will have so much capital represented by the freight traffic and we will pay dividends on that. I think you have got to take the thing as a co-ordinated whole. You cannot chop it up into bits and pieces.

Q. I agree with the approach you have just taken, but it was not quite what I had in mind. What I am concerned about is this. If in compliance with the statutory duty as a common carrier, the railways of this country are required to carry certain classes of traffic - and I am thinking, for illustrative purposes of passenger traffic - at a loss, would you consider that the passenger traffic should be subsidized as a payment for services rendered under that statutory obligation?

A. No, I do not think so; not unless one were limited entirely to carrying nothing but passengers.

Q. You say that if the Parliament of Canada imposes a duty on the common carriers of the country, there is no justification for Parliament paying for the carrying out of that statutory duty?

A. Only if, on looking at the co-ordinated whole,

you find that it is impossible for that particular entity, whatever it may be, to break even in the course of the thing on account of the Government forcing the carrier to do certain things. I think you have to consider the entity as a whole.

Q. Looking at the system of the C.N.R. as a whole, you would still find what you have just told me consistent with your attitude that the non self-supporting lines should be excluded?

A. Yes. I think there must be a little misconception. Maybe I have not made myself very clear. It is a very difficult distinction to make as to what is a Government enterprise side, and what is a commercial enterprise side. For instance, if the Government said to the C.N.R., "You have got to build a railway line up to Alaska," there can be only one good reason for that. It certainly is not for the purpose of running people up and down on holidays, and it is not for the purpose of carrying freight. It is purely as a national need, maybe of a military character. If they were instructed to do that, I say that there seems to be no good reason why the C.N.R. should be expected to make an earning to carry that kind of road. You can say the same with regard to the Newfoundland Railway. I do not know whether the C.N.R. wanted the Newfoundland Railway or not; but the Government, in its own judgment, said "Take it". I say if they do so take it, then you have got to segregate it. As I say, I do not know whether they wanted it or whether they did not want it.

COMMISSIONER INNIS: Would you, Mr. Shepard, carry that to the point of carrying Senators and Members of Parliament?

MR. SHEPARD: As a matter of fact, I think I would. I do not see why they should be carried at a loss, as they are, when they are travelling on a pass. I perhaps should say that without prejudice.

Q. Then, Mr. Norman, page 14 of your statement starts off with a special paragraph lettered (e). I want to refer to the last sentence there which reads as follows:-

> "If the rate structure is such that C.N.R. is unable to accumulate surplus earnings after an effective subsidy in excess of $30,000,000 per annum, certainly the C.P.R. will not be able to earn a sufficient amount to enable it to remain in a sound financial condition."

I suppose you would agree with me, Mr. Norman, that the condition of the C.P.R. as a corporation is something different from its condition as a rail enterprise only?

A. Very definitely.

Q. And it is quite possible in the future that not only will they continue to receive substantial dividends from Smelters, but they may receive increased royalties from their oil or any oil that may come in, from royalties on their oil lands?

A. Yes.

Q. So that it would be possible for them to remain in a sound financial condition as a corporation quite apart from the rail enterprise?

A. It would depend to a certain extent on the volume of their income from other sources than from the

rail enterprise.

Q. Yes.

A. And how long they can go on.

Q. That is right.

A. It just seems to me rather difficult to take the point of view that these other assets have got to carry the railroad.

Q. I am not suggesting that that point of view need be taken, Mr. Norman.

A. You are thinking of the financial stability of the C.P.R ?

Q. Yes.

A. As a corporation ?

Q. As a corporation.

A. I will agree with you.

Q. There is more than just the rail enterprise to be considered as to its corporate health?

A. Yes.

Q. Then the next sentence is one that I think Mr. Covert asked some questions about. You refer to "the conclusion that the basis for rate making should be laid down by law" rather than left to the administrative tribunal.

MR. CARSON: That is rather a legal question, is it not?

MR. SHEPARD: He has it in here. I should like to know why he put it in.

THE CHAIRMAN: Where is that?

MR. SHEPARD: The beginnning of the second paragraph on page 14, my lord.

Q. You say that the basis for rate making should be laid down by law . By saying that I presume you are suggesting that it should be in a statute?

A. Yes.

Q. I wondered whether you had any reason for preferring it to be in a statute rather than just a matter which would be determined before the administrative tribunal?

A. I would put it this way, that the basis for rate making, if we are on this basis, is so utterly different from the present method that you are going to have a very difficult time in changing the thinking, I think, of any tribunal unless they are instructed to do it that way.

Q You think if the C.P.R. should make application for a further increase on a rate rate of return on a rate base, it would not be considered on thatbasis by the board today?

A. I am expressing my own view now, not the C.P.R.'s view, sir.

Q. Yes?

A. I do not know. You will have to ask them.

Q. I presume that the answer you have just given me is why you suggest it be a statute?

A. Yes. It is difficult to get an entire change of mind unless it is done by instruction.

Q. You knew, of course, that the board of transport commissioners has been somewhat conditioned over the past two years to the rate base and the rate of return as it is in the regulation?

A. Yes.

Q So they are familiar with the question?

A. Yes.

Q. Then on page 19-- and this is the last point I want to take up with you -- you summarize your views. The first paragraph reads as follows:

"1. That the imbalance between revenues and the increased costs of labour and materials should be lessened as much as possible by further freight rate increases."

I think probably you would agree with me that further freight

rate increases might not necessarily result in increased revenues?

A. You are speaking of what may happen in the future?

Q. Yes.

A. That depends somewhat, does it not, on the economic development of this country?

Q It does. It depends on a number of factors. But what I am suggesting to you is that it is possible that further freight rate increases might result in the railways pricing themselves out of the market in certain types of traffic, and then having, as a result of that, a reduction in revenue rather than an increase in revenue.

A. It could. But I have heard just as many expressions to the contrary as in favour of that opinion.

Q We have had several on both sides in this court room also.

A. Not being a railroad expert, I am afraid that I cannot state that that would be the case.

Q. But it is a sort of general principle of merchandising that you cannot keep putting your prices up and continue to have bigger gross revenues indefinitely. You reach the point of diminishing returns.

A. That depends again on the state of our economy as a whole.

Q. That is right.

A. If the purchasing power of the dollar is going down, your revenues have to go up and the other fellow has got more of these so-called dollars to pay you. Sooner or later these things all find their level.

Q I suppose that you recognize in that statement number "1" there that the burden of further freight rate increases is very apt to fall on the long-haul traffic of this country?

A. I know nothing about freight rates.

Q. You have not considered the economic effect - -

A. No.

Q.--if the burden should fall on the long-haul traffic?

A. That is right.

Q. You have not considered that?

A. No.

Q Then I was going to make one final suggestion to you, Mr. Norman, and that was that among the ways that this imbalance that is suggested --which the provinces do not admit but rather deny -- might be corrected would be by increased volume , and I think you mentioned a moment ago the general development of the country. I suppose you would recognize that increased tonnage or increased volume of traffic of say 10 per cent would not increase the railway's operating expenses by 10 per cent, and therefore it would have a tendency to reduce whatever imbalance may be there, in your view?

A. It would be a very amateurish view that I am going to give you, because I am not a student of the economies of railways.

Q. We are perhaps two amateurs talking together.

A. I would say, as one amateur to another, that I think there is some degree in which this would not balance out, that there would be a greater amount of revenue than there would be expenses.

Q. Thank you very much.

THE CHAIRMAN: Is there anybody else?

MR. FRAWLEY: Yes.

CROSS-EXAMINED BY MR. FRAWLEY:-

Q. Mr. Norman, I should like to ask you just a question about your thesis on the rate base and the rate of return. You said you thought that was the proper way to arrive at a determination of what freight rate increase should be imposed.

A. Would you mind referring me to where I say that?

Q. Yes. At page 14. You say:

"...should be laid down by law as a reasonable return.."

A. Oh, yes.

Q You say that is the way that freight rates should be determined. You do not meanthat there should be a complete abandonment of the consideration of the requirements of those lines by applying the rate of return?

A. Not of necessity.

Q. If a rate of return next month should result in a dollar need, shall we say, to the Canadian Pacific of something of the order of $65 million, would you think that that should be awarded to the Canadian Pacific without further ado?

MR. CARSON: Without what?

MR. O'DONNELL: Ado.

THE WITNESS: In the first place, I do not think it would be awarded without any further ado. But I think you will find the same situation as I say is extant today in the United States, where, under the I.C.C. they do have this rate base and it is used as a measure. It is not lived up to, admittedly, but it is used as a measure. And then they arrive at a figure which is equitable to everybody concerned.

MR. FRAWLEY: Q. What I mean is this. The Canadian Pacific requirements, on the last occasion they went before the board, totalled I think $52 million or something of that order.

A. Yes.

Q. Now if by awarding them a freight rate increase on the basis of what it should be on a rate of return, on a rate base, and it should work out at say $70 million, would you say that they should have the $70 million without

any regard to the $52 million?

A. No, not of necessity.

Q. No. Then the $70 million would be weighed and considered in the light of the $52 million?

A. Yes, in the light of the $52 million.

2 Q. In other words, if they asked last year for a surplus over dividends and fixed charges of $15.2 million, would there be in your mind any justification for them saying, "Oh, well, we will take the $65 million and that will give us a surplus of perhaps double the $15.2 "?

A. Let me answer that in this way. My theory in adopting this as a principle is that the user of anything should pay a normal wage for the use of it.

Q. Yes.

A. The user of the railroad, irrespective of whether it be for freight or passenger traffic or any other type, should pay a normal return for the use of the thing which he is using.

Q. Yes.

A. Surely there is only one measure of what is the value of the thing that he is using, and that is the value of the property which is being used; not necessarily the value but at least the cost. Then the rate of return is what is and should be a normal rate of return; whether it be 4 per cent, 5 per cent or 6 per cent as was discussed this morning, I think is a matter of negotiation.

Q. Supposeit came out at a certain amount.

Suppose that, by by applying a certain rate of return to a certain rate base, it came out say to $65 million ; then would you agree with me that that would then prove that the rate of return which was applied was too high?

A. If it came to $65 million?

Q. If it came to $65 million in view of the fact that you find to day the Canadian Pacific's requirements filed with the board are $52 million. Assume those two figures with me.

A. No. I would not agree with you on that at all.

Q. Then you say "Let them have the $65 million"?

A. Yes.

Q. Yes. You think that the people of Canada --

THE CHAIRMAN: Those requirements include dividends, do they not?

MR. FRAWLEY: Yes; from memory they include dividends of $20 million; fixed charges of something of the order of $15 million or $16 million, and a surplus of $15.2.

Q. Do you think that that would be a satisfactory situation to the people of Canada, that the amount the Canadian Pacific is entitled to from the board of transport commissioners could rise in a period of months from $52 million to $65 million, and that that would give no concern to the people who have to pay the shot?

A. I do not understand the period of months.

Q. Take it from me, that is the last that we saw of the Canadian Pacific's requirements; they were $20 million dividends shaded by virtue of the exchange situation.

A. All right.

Q. $15.2 million surplus, the same surplus we have had presented since we started in the fall of 1946; $15.2 million; and fixed charges that have been lessened somewhat. Nobody knows that better than you, Mr. Norman. You are the man that signs the balance sheets.

A. All right.

Q. All right. Roughly I think there has been $52 million that we have presented as the Canadian Pacific's requirements.

A. All right.

Q. Now we can agree on that, can we, as being the list?

A. If those figures are correct.

Q. All right.

A. I will assume they are correct.

Q. All right. Then suppose by going into another sphere altogether and applying a rate of return on a rate base we come out with $66 million. Just consider those two figures.

The last requirements presented to the regulatory body was $52 million, but by applying a rate of return to a rate base it comes out at $66 million I simply put it to you as a citizen of this Canada of ours with some knowledge of the trend of public opinion, do you think that would be satisfactory to the people of Canada?

A. No. I do not think it would.

Q. No. So that you think probably we do not have to fear paying freight rates at anything more than on a requirement basis, whether they use the technique of the rate of return or not?

A. I do not think that the two at any given moment of time are comparable, because at one moment of time you may have a great deal of funded debt. You might have to borrow money at 6 per cent. You may be only earning 3 per cent. Naturally your requirements are greater.

Q. Yes.

A. But your investment is only represented by what you bought with that funded debt.

Q. Yes.

A. I do not see howyou can ever expect to get a rate of return which is always going to run parallel to the amount of requirements at any given moment of time because they are changing at every moment of time.

Q. But one must be tested with the other.

A Right.

Q. In other words, when the Canadian Pacific insist upon testing the requirements by saying what the rate of return would work out at, contrariwise, the rate of return would have to be tested by the requirements?

A. I agree with you.

Q. And if the requirements of the Canadian Pacific remain in that general neighbourhood of $52 million or something of that sort - I am not holding myself or you to that figure -- then it is what the rate of return truly should result in?

A. There again I would not want to commit myself to that, because I would want to examine first of all what made up those requirements.

Q. Yes. But whatever the requirements were, properly considered, that would be a check and balance on the rate of return?

A. I agree with you on that, yes.

Q. You have called attention to the fact, Mr. Norman-- and it has been called to the attention of many people by the Canadian Pacific Railway -- that the dividend these days is being largely supplied by the other income of the railway company?

e

A That is correct. I do not think I have called attention to that.

Q. I thought you mentioned that in the course of your remarks.

A. No.

Q. There is nothing extraordinary about that, is there?

A. I would say there is.

Q. Would you say that the Union Pacific's dividend was not due in part to revenue it receives from its coal mines and oil wells in Wyoming?

A. I would not want to say.

Q. Would you not be surprised --

A. I would be surprised if it was not so.

Q. You would be surprised if it did not?

A. Yes. I should like to add to that that when you ask why should not they receive a part of this in this way, I think it depends entirely on the relative investment.

Q. What do you mean by that?

A. On what is the cost of your investment.

Q. I am just a little bit uncertain as to what you mean by that.

A. If you have $1.3 billion invested in the railroad, and whatever the figure may be in other assets, which is very very much less, one would normally expect that that relative amount to be contributed to the dividends is relative to the amounts of the investment, not in the varying situation in which one investment may particularly find itself.

Q What do you call the investment of the Canadian Pacific today in Smelters?

A What do I call it?

Q. Yes.

A. I do not know whether it is set down here separately or not.

Q. Its value as a going concern, I mean; not under the sheriff's hammer or anything of that sort.

A. No. I do not see the value of it here. I think it depends on the cost of it, how much money have you got invested; that is the cost.

Q. Is that the way you compare it?

A Yes.

Q. You compare the railway assets, bridges and stations and all that with what they would give to Smelters?

A. With the costs.

Q. What is the cost? Because you would know if any one does.

A. Just offhand, as I say I do not know. I do not think it is indicated here.

Q. That might be worth while finding now. I think we would just like to have that.

MR. COVERT: It is on record now.

MR. FRAWLEY: Mr. ~~Frawley~~ can probably pick it out of this report.

THE CHAIRMAN: What you want is the amount of investment of the Canadian Pacific in Consolidated Smelters?

MR. FRAWLEY: Yes.

COMMISSIONER INNIS: I thought you wanted the cost.

MR. FRAWLEY: Mr. Norman is going to give us the cost. We can perhaps get both, what they paid for it and -- that would be the cost, of course.

THE WITNESS: I would have to ascertain that. I do not see it here.

MR. FRIEL: Page 27.

MR. FRAWLEY: Consolidated Smelters.

THE WITNESS: $8,412,000.

MR. FRAWLEY: Q. $8,412,000?

A. Yes.

Q. What would you think those properties out there are worth?

A. I have not the slightest idea.

Q. They would be worth a lot more than $8 million?

A. Yes; considerably.

Q. Many times more than $8 million.

A. Yes.

Q. But you think it would be quite all right to put that down at $8.4 million, along with the rails and ties and put it in their accounts at cost too?

A. At cost too. When I am looking at my capital

structure, I am not looking at an appraisal; I am looking at the capital structure.

Q. You are looking at the capital structure?

A. Yes.

Q. But you would not use the capital structure to base a rate of return on a rate base.

A. No. But you were asking me, in your last question, whether I know whether a large amount of these dividends were paid on common stock out of these other earnings.

Q. That is right.

A. And I said that I was so informed.

Q. Yes.

A. Then you asked me whether, as I understood it, it was not justified it should be so paid.

Q. Yes.

A. And I said that I thought that the investments, having due regard to the amount of money invested in such investments, should bear their equal proportion and not expect one to carry the whole of the load.

Q Without any regard to the revenue-producing possibilities of the investment, just what it cost?

A. That should automatically create a greater dividend.

Q. You know that the Canadian Pacific in one year gets about twice what it originally paid for the investment?

A. Yes.

THE CHAIRMAN: We will adjourn now.

--The Commission adjourned at 4.45p.m. to meet again at 10.30 a.m. on Wednesday, April 26,1950.

A.R.

ROYAL COMMISSION
ON
TRANSPORTATION

EVIDENCE HEARD ON

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VOLUME

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ROYAL COMMISSION ON TRANSPORTATION

Ottawa, Ontario

Wednesday, April 26/50

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ROYAL COMMISSION ON TRANSPORTATION

OTTAWA, ONTARIO
WEDNESDAY
APRIL 26, 1950.

THE HONOURABLE W.F.A. TURGEON, K.C., LL.D. - CHAIRMAN

HAROLD ADAMS INNIS - COMMISSIONER

HENRY FORBES ANGUS - COMMISSIONER

G.R. Hunter
Secretary

P.L. Belcourt
Asst. Secretary

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C.F.H. Carson, K.C. F.C.S. Evans, K.C. K.D.M. Spence I.D. Sinclair	Canadian Pacific Railway
C.W. Brazier	Province of British Columbia
J.J. Frawley, K.C.	Province of Alberta
M.A. MacPherson, K.C.	Province of Saskatchewan
C.D. Shepard	Province of Manitoba
J. Paul Barry	Province of New Brunswick
Frank D. Smith, K.C.	Province of Nova Scotia

Ottawa, Ontario,

Wednesday, April 26, 1950

MORNING SESSION

HENRY GORDON NORMAN, recalled

CROSS-EXAMINATION BY MR. FRAWLEY (Cont'd)

Q. Mr. Norman, continuing from where we left off last evening, you told me at the very end of your evidence at page 20710:

"And I said that I thought that the investments, having due regard to the amount of money invested in such investments, should bear their equal proportion and not expect one to carry the whole of the load."

We were talking about the Other Income of the railway as a source for dividends, I think, in a general way.

A. Mr. Frawley, before I answer that question I should like to make one correction in regard to the question you asked me as to the cost of Consolidated Smelters investment.

Q. What page?

A. Page 20709, in which the reply was that it was $8,412,000. That was taken from the C P.R. report, but that is the par value of the stock and not the cost. I have since ascertained the cost through the accounting personnel of the C.P.R. and am advised the cost is $17,046,000.

Q. What is the figure again?

A. $17,046,000.

Q. Exactly what is that again?

A. That is the cost of the investment in the Consolidated Smelters capital stock.

Q. That is what the Canadian Pacific paid for the shares, for 51 per cent of the stock?

A. Which they presently own.

Q. Which they own?

A. That is correct.

Q. Now that you have raised that question would you be good enough to let us have a breakdown of that $17 million. I do not recall having had that figure put into the record at any time before.

A. How do you mean a breakdown?

Q I mean to let us have a complete statement as to that $17,046,000. I ask that because, as I say, I have never seen that figure before or had it brought to the attention of this Commission or the Board of Transport Commissioners. I suppose the same people who gave you the figure could, without a great deal of research, give you the make-up of it, how much was the investment originally because I understand it began with an investment of some $600,000 as you would perhaps expect it would away back in 1897. I think Mr. Walker told us that.

MR. CARSON: Is the Commission concerned with the details or a breakdown of that?

MR. FRAWLEY: My friend would rather --

MR. CARSON: I am asking the Commission, not Mr. Frawley.

THE CHAIRMAN: This figure which Mr. Norman has given represents the price paid by the Canadian Pacific Railway for shares?

THE WITNESS: That is correct.

THE CHAIRMAN: That is all it is. How can you break that down?

MR. FRAWLEY: Because it was not spent all on one day. Perhaps some of that was bought when the stock was -- I don't know at all, but it may have been bought on the market at a high price, and I think we should have

the complete picture.

THE CHAIRMAN: Does that make any difference?

MR. FRAWLEY: In my submission --

THE CHAIRMAN: Is it not a legitimate investment?

MR. FRAWLEY: Oh, yes, I am not questioning the legitimacy or propriety of the investment. I am not questioning that at all, but it does seem to me we should know more about that figure.

THE CHAIRMAN: We are told now that the $17 million odd was paid out for shares in that company. You want to know the particular dates on which payments were made?

MR. FRAWLEY: I think if it were broken down by years it would be satisfactory.

THE CHAIRMAN: How many have been bought one year and how many another year?

MR. FRAWLEY: That is right.

THE CHAIRMAN: What would you argue if you had that? There is no use going to the trouble of having it unless it means something. What would you deduce from that?

MR. FRAWLEY: It would certainly serve to inform the Commission as to the circumstances under which the Canadian Pacific acquired the Smelter stock and the prices they paid, whether they bought it on the market, whether they bought it originally from the people who were operating it. I don't know anything about it at all.

MR. CARSON: So what?

THE CHAIRMAN: Is it going to be of any use to us when we get it? What do you say, Mr. Carson?

MR. CARSON: Suppose all this is true and Mr. Frawley gets the circumstances. I still do not know

where that leads us.

THE CHAIRMAN: I must confess that so far I do not either.

COMMISSIONER ANGUS: Did the discussion not arise out of the question of what the dividend from other investments was, what the other income of the Canadian Pacific was, and what relation it bore to the costs of other investments?

MR. FRAWLEY: That is right. I think that is when it came up.

COMMISSIONER ANGUS: I do not see how it would be helpful to have what you ask.

THE CHAIRMAN: You had better think this over yourself, Mr. Frawley, and if you come to the conclusion there is anything to be gained by the Commission having it you can raise the matter again.

MR. FRAWLEY: With respect, I would not have thought that I should have had to ask the Commission to direct it. I would have thought that the Canadian Pacific was so anxious to show that they paid $17 million for this stock which is there at $8 million that they would have themselves come in with this information. I do not suppose the people of Alberta are going to worry too much about it, but representing them here I would have thought that Mr. Norman, if he went to the trouble of getting the figure of $17 million, would have come in with something more than a figure, with a memorandum indicating how that was built up.

MR. EVANS: He went to the trouble because you asked for the figure. He gave you the figure of the par value instead of the cost.

THE CHAIRMAN: If you can tell us later on some good reason why it would be beneficial to our inquiry

to have that information we will consider the matter again.

MR. FRAWLEY: Very well, my lord.

THE CHAIRMAN: We have a whole lot of material now.

MR. FRAWLEY: Q. Mr. Norman, dealing now with the availability of the Canadian Pacific Other Income to furnish moneys for the payment of dividends, I think you told me yesterday and I want to be clear so I shall ask you again whether you regard that as a proper source for the payment of dividends?

A. Other Income?

Q. Yes.

A. Most decidedly, but not a source of payment of a dividend which is deemed to be a return on the railroad investment.

Q. Would you think that the people of Canada who pay the freight rates might expect some change in the attitude of the Canadian Pacific towards this Other Income as a source of dividends?

MR. CARSON: Just a minute. That is a peculiar question. Why should Mr. Norman be asked to attempt to appraise what the people of Canada may think?

THE CHAIRMAN: I do not say that the matter is not admissible, Mr. Frawley, but is Mr. Norman in a position to answer your question?

MR. FRAWLEY: My lord, Mr. Norman is the resident manager in Canada of Price, Waterhouse, the largest firm of chartered accountants in Canada. I want to know what the view of the witness is with regard to this inviolability of Other Income toward payment of dividends of the Canadian Pacific Railway.

MR. CARSON: That is not the question you put.

THE CHAIRMAN: That is not the people of Canada you had in your first question.

MR. FRAWLEY: Well, perhaps I did not put the question exactly the same.

THE CHAIRMAN: Q. Can you answer the question now put by Mr. Frawley?

A. Yes, my view is that you have in the Canadian Pacific Railway as a corporation two investments. You may have more, but in any event you have two in the form of the investment in the railroad and the investment in Consolidated Smelters. So far as dividends are concerned I think for all practical purposes they should be kept segregated, and I can see no reason why the earning from a prudent investment in something outside of the railroad itself should of necessity be used to pay a return on the common stock which was originally invested in that railway.

MR. FRAWLEY: Mr. Norman, the Canadian Pacific is anxious that the Canadian National, rehabilitated in accordance with Mr. Gordon's plan, be not made the yardstick for freight rate purposes. That is pretty clear, is it not?

A. Yes.

Q. Now, do you think that the Canadian Pacific would be willing to say to the freight shippers of Canada, "If we are permitted to remain the yardstick and the Canadian National is left out of the picture as it is at the moment we will be willing to have all of the dividends paid out of Other Income and to allow the financial picture on the railway side to be that much better"?

MR. CARSON: How can this witness be asked to say what the Canadian Pacific should say to the shippers of Canada?

THE CHAIRMAN: Perhaps he is ominiscient; I don't know.

Q. Can you answer that?

A. No, I am not prepared to answer that. That is a matter of judgment for the management of the Canadian Pacific Railway. I have no ideas as to that policy.

MR. FRAWLEY: Mr. Norman has come here to support the Canadian Pacific attack on the Canadian National proposal, and it seems to me that I am entitled to put these questions to him.

THE CHAIRMAN: If he can answer them he should answer them but he says that he cannot, so what are you going to do about it?

MR. EVANS: In any case suppose he could answer it; he could not bind the Canadian Pacific.

THE CHAIRMAN: He is asked what he thinks the Canadian Pacific ought to do or might do.

MR. EVANS: What good would that be?

MR. FRAWLEY: Q. Do you think, Mr. Norman, that as a consideration for permitting the Canadian Pacific to remain the yardstick for freight rate purposes, and in view of the probable and possible consequences of the Canadian National proposal, that the dividend on the common stock should be reduced below 5 per cent? Do you think it would be fair for the Canadian Pacific to offer that to the freight shippers of Canada?

MR. CARSON: I still object to that.

THE CHAIRMAN: No, I think if Mr. Norman can give us his opinion he had better give it.

THE WITNESS: I have no opinion on that matter whatever in view of the fact that I have not been asked and have not given consideration as to whether there

should be or should not be any quid pro quos.

MR. FRAWLEY: Q. That is an interesting answer, Mr. Norman. Have you ever considered any quid pro quos at all for complete rejection of the Canadian National plan?

A. Definitely not, because I do not think they are necessary.

Q So far as you are concerned the Canadian Pacific remains just where it is now, and everything that it is asking for in the way of requirement must all be given to it regardless of the Canadian National plan?

A. Well now, you are getting back to the question of requirements.

Q. Yes.

A. I think that it might be advisable for me to refer to the questions that you asked with regard to requirement at pages 20706 and 20707 of yesterday's testimony.

(Page 20718 follows)

Q. Yes?

A. In which you at page 20706 raised this question of requirements by asking me this question:

"Q. But one must be tested with the other ."

To which I agreed.

THE CHAIRMAN: One must be what?

A. One must be tested with the other. That is the question. I had made this answer:

" A. I do not see how youcan ever expect to get a rate of return which is always going to run parallel to the amount of requirements at any given moment of time because they are changing at every moment of time.

Then Mr. Frawley said:

"Q. But one must be tested with the other."

To which I agreed. And on page 20707 Mr. Frawley said:

"Q. In other words, when the Canadian Pacific insist upon testing the requirements by saying what the rate of return would work out at, contrariwise, the rate of return would have to be tested by the requirements? ."

To which I said I agree with you."

I do not want to leave either with Mr. Frawley or with the commission the impression that once a determination has been made of the appropriate rate, a proper rate of return on investment, that from time to time this has to be tested with the requirements as they are so described in the various judgments of the transport board. I say that any normal body of people that are going to hear argument as to the proper rate of return naturally during the transitional stage look at what their former judgment was based on requirements. But it would be impossible, or it would be entirely contrary to the spirit of rate making by means of a proper return on a proper investment, otherwise the wages of investment;

because you could have one enterprise with a large amount of funded debt and a small amount of capital stock ; you could have another enterprise with no funded debt practically and a large amount of capital stock, a much larger amount. And those things can vary from day to day, from week to week and from month to month.

Q. You read what I asked you at page 20707? A. Yes.
Q. I asked:
"Q. In other words, when the Canadian Pacific insist upon testing the requirements by saying what the rate of return would work out at, contrariwise, the rate of return would have to be tested by the requirements.

A. I agree with you.

That is whatyou said.

A. That is correct.

Q . Then I asked you this question:

"Q. And if the requirements of the Canadian Pacific remain in that general neighbourhood of $52 million or something of that sort - I am not holding myself or you to that figure -- then it is what the rate of return truly should result in?

A. There again I would not want to commit myself to that, because I would want to examine first of all what made up those requirements.

Q. Yes. But whatever the requirements were, properly considered, that would be a check and balance on the rate of return.?

A. I agree with you on that, yes. "

Now, Mr. Norman, do you think we were at cross purposes yesterdayd when you were telling me about the ;manner in which the requirements you have were used as a check and balance on rate of return figure?

A. I think we were at cross purposes to the extent that it should continue after the transitional stage. As to the transitional stage, the Board would naturally look at their previous judgment.

Q. What would be the transitional stage? I do not understand that.

A. If the law were amended as I have suggested, that the regulatory board be directed to fix rates based upon a reasonable rate of return on a proper investment basis, then that is the thing by which they would be bound.

Q. Do you mean to say they would be bound to award whatever emerged from the application for a rate of return on a rate base?

A. Whatever they themselves decide was the proper emergence.

Q. If they simply take a rate of return rate to be based upon the going value of money and then apply that to a properly approved rate base, and it came out, we will say, in this year 1950, or six months from now, if we have another rate case, at $65 million or $70 million, would you say that they would forthwith award that?

A. It is not within my province to say what other people will do.

Q. Yes, I understand. But would it be proper in your view that they should award $70 million?

A. Yes.

Q. That is what I want to see. Notwithstanding the fact that as of three months ago the Canadian Pacific proposed requirements amounting to $52 million?

A. Yes.

Q. You think that it would be quite proper for the regulatory body to advance those requirements of

$52 million to $70 million on a rate of return basis and award freight rates accordingly?

A. Yes.

Q. If the dividends were left alone at 5% and 4% and the fixed charges were left as they are now, perhaps with some reduction, then it would mean doubling perhaps the surplus which has been awarded?

A. That is quite conceivable.

Q. You say that is how freight rates should be arrived at?

A. Based upon the judgment of the Board itself as to what is a proper rate and determined by the proper evidence. You are assuming that it is always going to be higher.

Q. Yes.

A. It may be lower, quite easily.

Q. Would it not mean this. If $70 million emerged on that sort of calculation, would it not mean a rate of return which was too high in the light of the Company's requirements?

A. Not exactly.

Q. You do not think that would even be a consideration?

A. As to their rate, no.

Q. As to the propriety of the rate and the rate of return?

A. No. I think their consideration is what will the amount of the yield be and what is the cost of the money.

Q. Let me understand you: In your opinion, what the turning over to the rate base and a rate of return is going to mean to the people of Canada, so that some of us representing the people of Canada can take a position

in the matter. You say it might very well mean that the surplus presently accorded to the Canadian Pacific at their own request of $15.2 million might very well be increased to $30 million on the rate of return basis?

A. I have not said that. That is the suggestion you make.

THE CHAIRMAN: Did you say "to" or "by"?

MR. FRAWLEY: To $30 million.

THE WITNESS: That is your suggestion. I have not said it would.

MR. FRAWLEY: Q. You tell me that if the requirements as a result of applying the rate of return on a rate base was $70 million as of today, that is quite all right with you?

A. Yes.

Q. Then I say with the fixed charges remaining as they are, this may increase the Canadian Pacific's surplus from $15.2 million perhaps to $30 million; in other words, it may double it. You think that would be all right?

A. That would be all right.

Q. And that your freight rates should be made on that basis?

A, Yes.

Q. So that out of the blue sky, assuming your requirement base and rate of return base, the Canadian Pacific gets its surplus increased by 100%?

A. That is an assumption which you are making, that it would be increased.

Q. But if they dealt with it in that way, that would be quite all right?

A. Yes. Because my answer to that would be

that in the days when the C.P.R. has not received proper compensation for the use of its property.

Q. Do you know what that would mean in the way of increasing freight rates in this country?

A. No. I have no idea.

Q. You do know that Mr. O'Donnell put a figure to Mr. Northey Jones that to secure a dollar result of $66 million to the Canadian Pacific Railway it would mean on Mr. O'Donnell's instructions, about 24% freight rate increase over existing freight rates?

A. If Mr. O'Donnell stated that, all right. It is Mr. O'Donnell's statement, not mine.

Q. Let us assume that competent accounting officers and traffic officers made that calculation for Mr. O'Donnell. Does that give you any concern at all?

A. Will you repeat the statement that you made?

Q. Which statement?

A. As to the dollar result of, 66 million,. I do not know what you mean.

Q. What Mr. O'Donnell put to Mr. Northey Jones was that Mr. O'Donnell was instructed that if there was to be a dollar result to the Canadian Pacific of $66 million, on Mr. Northey Jones' proposition that the common stock should earn 10% in matters of that kind, that that would mean the necessity of increased freight rates of 24% over the existing level of freight rates. Now, let us assume again that that is correct. Assuming that that is a correct calculation that Mr. O'Donnell's people made for him, I say to you this: Does that cause you any concern at all for the people of Canada that have to pay that amount of freight rates?

A. I think my answer to that is that the consumer

should pay a proper wage on the use of the investment and that is what he would be doing.

Q. I just want to be clear. You tell me that the people of Western Canada, as far as you are concerned, must be content to go ahead and pay 24% more in freight rates increased over the present level in order to give the Canadian Pacific what Mr. Northey Jones thinks they should have?

A. I am not saying what the people of Western Canada want or do not want it.

Q. Do you know whether or not the situation has now arrived that competitive rates are just about as high as they can be put?

A. I do not know. I have heard that expression in one quarter and I have heard the opposite expression in another.

Q. Have you made it your business, as a part of these far reaching suggestions of yours, to acquaint yourself with what is going on in the freight rates structure?

A. No, sir.

Q. No. But if it should happen, and I would ask you just to assume with me, whether I may be right or wrong, that a further increase in freight rates awarded any time after today could not be put on the competitive traffic by and large, you would still say that the people of Canada could stand a 24% increase?

A. If it cannot be put on, it cannot be put on. I think you have answered your own question.

Q. So we would put it on the non-competitive traffic, the only place it could go; and that again is a thing that causes you no concern?

A. No.

Q. No .

A. Because one always has to remember that there is in this economic world a different dollar which we are talking about, and the so-called dollar increases are related to some extent to the dollar increases which the consumer is getting for his goods.

Q. But whatever it is, it does not cause you any alarm to think that that great area in central Canada where the competitive rates are paramount, are not taking any increase and it is going on the outlying districts where the non-competitive traffic is predominant. That does not give you any concern?

A. You are making a statement to me which I am not making.

Q. I am making assumptions and asking you if these assumptions are correct, you are still not at all concerned with the consequence?

A. No, sir.

Q. All right.

MR. EVANS: I am sure Mr. Frawley did not intend the question as he has put it.

MR. FRAWLEY: I did. I do not like my friend to tell me that I do not intend my questions as I put them.

MR. EVANS: Let us see if we do agree. My friend put a question to the effect that that great area in Central Canada would get no increase. If you want to read it back from the record, all right.

MR. FRAWLEY: That is what I said.

MR. EVANS: That is pure nonsnese.

MR. FRAWLEY: I resent my learned friend saying

that is nonsense, and I throw it back in his face. I am not talking nonsense. I am speaking now of that great area in central Canada and saying that the freight rates would not be increased as they would be inevitably in the non-competitive area. I stand by that. My friend may think it nonsense - -

MR. CARSON: We are not speaking of the same thing at all.

THE CHAIRMAN: You are drawing that deduction from past experience?

MR. FRAWLEY: Yes, I do, my lord, and I draw it from what Mr. Evans himself stood up in the Transport Board and said. We do not need to go over it all again now. It is there on record.

MR. CARSON: My friend very skillfully rephrased his question to make it different in order to get out of trouble.

MR. FRAWLEY: I am not concerned about your views about what I am doing at all, Mr. Carson.

Q. And now, Mr. Norman, I take it that the alarm of the Canadian Pacific arising out of the Canadian National Pproposal varies in accordance with the degree of the invasion of the C.P.R. security which is latent in that scheme?

A. By "security" what do you mean?

Q. The Canadian Pacific's security now is the yardstick for the making of the freight rates.

A. If you are speaking of the security of the railroad enterprise as a railroad enterprise, that is one thing. If you are speaking of the security of the C.P.R. as a corporation, that is another thing. Will you just clarify what it is you are speaking of?

Q. I am speaking of this kind of security. The Canadian Pacific can go to the Transport Board, as they have done, and get so many millions for its dividend requirements, so many millions for its fixed charges, and so many millions for its surplus. I call that security. You can call it something else. That is what I mean when I say "security". The degree of alarm that the Canadian Pacific has evidenced here is dependent upon the manner in which the Canadian National proposal might invade that position?

A. I would say that is not complete statement of the facts. From my point of view -- and I cannot speak for the C.P.R -- I say there is quite a definite cause for alarm that if the Canadian National end up with substantial surpluses in the one case, if they have a free pocket of money to do as they see fit with, that must bring about a condition which must cause alarm to the C.P.R.

Q. You do not think that the feeling in the country that perh the Canadian National, the railway which the people of Canada own, should be the yardstick, is going to be very much concerned about that?

MR. CARSON: I do not know that that question should be put to this witness, about the feeling in the country.

MR. FRAWLEY: Q. You are resident manager in Canada of Price-Waterhouse?

A. I would say "partner" not manager.

Q. You are resident partner?

A. Yes.

Q. Pardon me for using the word "manager". You are resident partner. You offices extend from the Atlantic

to the Pacific?

A. That is correct.

Q. You have offices in every Province in Canada?

A. Yes.

Q. And you make it your business to go there. You are in charge of those offices?

A. Yes.

Q. And you make it your business to go from one end of Canada to the other?

A. From time to time.

Q. Notwithstanding the inferior position in which my friend Mr. Carson may want to put you as an appraiser of public opinion, I simply put it to you in this way. Do you not think that it is more than likely that there is a large body of public opinion in this country that might want to see the Canadian National made its yardstick, regardless of these consequences?

MR. CARSON: What is he to do - take a Gallup Poll? I do not understand this line of questioning by my learned friend.

THE CHAIRMAN: Mr. Norman is asked to state from his experience as a citizen of Canada, travelling throughout the country, whether or not he does not believe that there may be a body of public opinion. That is what you say; not that there is, but that there may be.

MR. FRAWLEY: That is right, that there may be.

THE CHAIRMAN: That there may be in Canada a feeling that the Canadian National should be the yardstick in setting freight rates instead of the Canadian Pacific.

MR. FRAWLEY: That is all.

THE CHAIRMAN: Q. What do you think, Mr. Norman?

A. My only answer to that can be that if all the facts

were put before every person --

Q. I am just taking things as they are.

A. As they are, my personal opinion is that I do not think there is such a quantum of people. I do not think they are well enough informed.

(Page 20730 follows)

COMMISSIONER ANGUS: When we are speaking of the Canadian National being a yardstick, have we in mind the Canadian National with its present capital structure or with the capital structure it is asking for or with the capital structure which it has been suggested in this brief it should have?

MR FRAWLEY: I am speaking, sir, of the Canadian National capital structure which Mr. Gordon placed before the Commission.

COMMISSIONER ANGUS: Would there be any objection to the Canadian National being a yardstick if its financial structure were what has been suggested in this brief, if the proposals on page 16 were given effect to, so that the revenue needs of the Canadian National were defined on that basis? Would there be any objection then to its being a yardstick?

THE WITNESS: Mr. Angus, I would like to answer that this way: Firstly, my suggestion is that the basis of fixing freight rates should be on the basis of a fair return on the investment, and if that is a basis to be used I see no objection to the Canadian National being a yardstick along with the Canadian Pacific -- none whatever.

COMMISSIONER ANGUS: Q. When you say a fair return on an investment, that would be subject, I suppose---

A. On the property.

Q.--To the exclusion of the investments made for the purpose of national policy?

A. Yes, sir.

Q. And on that basis would you see any difficulty in using two yardsticks, each to some extent being a check on the other?

A. No inherent difficulty, no.

MR FRAWLEY: Q. What you are saying, Mr. Norman,

to the Commission that has to consider this Canadian National proposal, is that there are some conditions which should be imposed before it is accepted, I mean the conditions which are contained in your own submission?

A. Those are hardly conditions of the acceptance. I think one can hardly say that a suggestion that $300 million should not be granted as a subsidy is a condition, because it just is not a condition.

Q. You do not reject the whole plan out of hand?

A. Oh, no.

Q. And say it is not worth talking about?

A. Oh, no.

Q. So I perhaps wrongly used the word "condition". You say if it is to be accepted it must be accepted in accordance with my suggestions, contained in your statement?

A. I did not say that, sir. I said that is my suggestion as what might be acceptable.

Q. Well, it is for the Commissioners to say whether it is to be accepted in whole or in part?

A. Yes.

Q. Or with conditions, or as you have placed it, and so on; but you are saying to the Commissioners virtually that if you will regard it in the light of my statement, then it is all right to accept it, or what is left of it?

A. I would hardly be quite so presumptuous as that. I merely express my views as to what I consider might be done.

Q. I find it difficult to follow you. You are not saying---

A. I am not in a position to direct the Commission as to what they should do. That is the suggestion which you made to me.

Q. But surely you appreciate the fact that you are not here directing the Commission, but you are here making respect-

ful submissions to the Commission?

A. That is right.

Q. And in your respectful submission, if the Commission followed the suggestions contained in your brief, then it would be all right to go along with the Gordon plan; that is a fair way to put it, isn't it?

A. Yes.

Q. All right. We were a long time getting that. These things, then, that you say about the Gordon plan, in a word, are, first, that the $300 million must go?

A. In that form, in that form.

Q. That instead of exchanging the bonded indebtedness of $760 million for equity capital, that should be exchanged for income bonds?

A. That is correct.

Q. With a cumulative feature?

A. That is right.

Q. And that means---

A. Not the whole $760 million.

MR CARSON: Take his brief as he put it.

THE WITNESS: I think you will find it is $391 million, if you will read it.

MR CARSON: Page 19.

MR FRAWLEY: Q. All right. And that means that unless the---

THE CHAIRMAN: Where is that?

MR CARSON: Page 19, paragraph 2, summary of his views.

MR FRAWLEY: Q. And that means that if the income is not sufficient to have the bonds earn, then the deficits reappear in the annual statements?

A. No, sir.

Q. Well, what happens?

A. The deficit would not appear. To the extent that it is earned it would show that that amount had been paid on the contingent interest basis, and the matter of the remainder is merely a contingent liability, as one sees on all sorts of commercial branches.

Q. All I am concerned about---

A. It does not show as a deficit.

Q. I am concerned to see what difference there would be in the annual statement then. Take 1949, for instance -- page 6 of the annual C.N.R. statement, Exhibit 254 -- there were two amounts there that had to be paid, $24 million to the public and $21 million to the Government, out of the $4 million of net income. How would that appear under your income bond arrangement?

A. To the extent that it is the amount of interest on the income bonds, it would not be stated in there at all as a charge.

Q. The interest on the funded debt in the hands of the public would remain there, I take it?

A. Yes.

Q. And the interest on the Government loans of $21 million would disappear?

A. It would be reduced by approximately I think it is $13 million.

Q. And that would appear then as $21 less $13 million?

A. It would not be less anything; it would appear as $8 million.

Q. It would appear as $8 million?

A. Yes.

THE CHAIRMAN: Q. It would appear as what?

A. As $8 million.

MR FRAWLEY: Q. So that in 1949, as a result of the recapitalization, just in these particulars that you

would go along with, it would be $24 million and $8 million?

A. That is approximately correct.

Q. There would be about $32 million there that the railway would have to find out of net income of $4 million?

A. Yes, or out of a Government -- a subsidy paid to it.

Q. The loans which the Government give them are loans for their deficits?

A. Loans?

Q. Yes.

A. No, sir; there is no loan made for any deficits.

Q. Now, how is the deficit treated? Does that not appear somewhere in the capital structure?

A. No, sir.

Q. Tell me how that happens, Mr. Norman -- the $33 million in 1948?

A. I think if you look at the consolidated balance sheet of that exhibit you are speaking to, at December 31, 1949, you will see an item under current assets, balance due on deficit account.

THE CHAIRMAN: Q. Balance due on what?

A. Due on deficit account; and that is the balance outstanding at that time which is due to the Canadian National by the Government of Canada in respect of deficits.

MR FRAWLEY: Q. Now, the third comment that you have to make on the Gordon plan is that the uneconomical lines must be segregated, and they must be put into the hands of the Canadian National on an agency basis?

A. That is correct.

Q. Just as the Hudson Bay Railway has done?

A. Yes.

Q. Now, the Commission has been told that the Canadian National proposed that scheme to the Government

of Canada in connection with the Newfoundland Railway, and the proposal was rejected, and it went in just as the Temiscouata has gone in, and the Intercolonial and all the rest of them. Now, don't you think that we should be realistic, or what is your position about that? Do you think that, notwithstanding that, perhaps the Commission, if they agree with you, should say to the Government, "Well, that attitude should be changed."

A. I see no objection to so saying.

Q. Then you say on page 20, Mr. Norman, that the balance of any surplus earnings must be paid to the government as a return on its equity capital; you do say that, don't you?

A. I would like you to read the whole, because that does not give a correct --

Q. Well, what you say is that a portion of surplus earnings afterpayment of interest, fixed and contingent, should be retained to provide funds for improvements and betterments and the balance paid to the government as a return on its equity capital?

A. Correct.

THE CHAIRMAN: Q. Well, the other day it was suggested that the distribution should be half and half. I am not sure who made that suggestion; was it you?

A. I think it was, sir.

MR. O'DONNELL: Mr. Northey Jones, too.

THE WITNESS: I think Mr. Northey Jones also made the same suggestion.

MR. O'DONNELL: One dollar paid, one dollar retained.

MR. FRAWLEY: Q. Now, that is tantamount, of course, to virtually paying dividends to the government of Canada, isn't it?

A. It is paying them a return on their equity, on their investment, certainly.

Q. And that is what a common shareholder in an ordinary company gets?

A. Certainly.

Q. So that would put the Minister of Finance of Canada in the position where under your suggestion he would be receiving dividends from this publicly-owned enterprise?

THE CHAIRMAN: That may be done today, may it not, under the law?

MR. FRAWLEY: Yes, it may be done; it may be done.

THE CHAIRMAN: If the directors of the company wish.

MR. FRAWLEY: That is true.

THE CHAIRMAN: Pays the whole or any part of the surplus to the government.

MR. FRAWLEY: Yes, that is true. As I understand, that has not been done.

THE CHAIRMAN: This would make it compulsory.

MR. FRAWLEY: That is right; this would make it compulsory.

Q What I am suggesting to you there, Mr. Norman, is, to make it compulsory would fly in the face of the whole concept of public ownership of utilities, wouldn't it?

A. Not entirely, no. I never can conceive the reason why they burden -- I will put it this way, that the burden of financing a public enterprise shouldhave no return on it whatever, because you are giving a service to one group of taxpayers and having another group of taxpayers pay for it, and from my own theoretical point of view I consider this entirely unsound.

Q. Of course, you are pretty well a private enterprise man, are you not?

A. I don't know what you call it, but if you mean to say that I am in favour of the capitalistic system, I would say yes.

Q. Well, does that go to the point where you see no place, for instance, for a state-owned telephone system?

A. None whatever. I do not say that I either agree or disagree. I won't say that I disagree.

Q. Then you say at the bottom of page 8 and the bottom of page 9 -- this is the objective:

> "The placing of the commercial or self-supporting part of the enterprise on a basis comparable with the investor-owned companies as to capitalization, operating expenses (including taxes and depreciation) and charges payable as an overall return on capital."

That is again saying that what you call the commercial part of this enterprise should pay income taxes?

A. That is right.

Q. Well, now, there again, Mr. Norman, that is flying in the face of law and practice in the field of publicly owned utilities?

A. That is perfectly true, but there may be some other method, if you wish to so design one, by the government, under which instead of taxes they can call it something else. But certainly, once again, I see no reason why one group of taxpayers should be paying as a burden on another group of taxpayers, and that is what you are asking.

Q. Of course, when you look around you find that is actually what is going on all over Canada, when you have a state-owned utility competing with a privately-owned

utility?

MR. CARSON: What have you in mind?

THE WITNESS: What particular ones have you in mind?

MR. FRAWLEY: Q. Have you not got a state-owned utility in the province of Quebec?

A. Competing in the same area?

Q. I don't know about the area. Have you got something called Hydro Quebec?

A. Oh, yes, definitely.

Q. You have something called the Gatineau Power?

A. Yes.

Q. One of those corporations pays income tax and the other does not pay income tax?

A. That is correct.

Q. In the city of Winnipeg you have the Manitoba Power Commission and the Winnipeg Electric?

A. That is right.

Q. And one pays income tax and the other does not?

A. That is right.

Q. Thank you, Mr. Norman.

THE CHAIRMAN: Anybody else?

MR. O'DONNELL: I have just a few questions, my lord.

CROSS-EXAMINED BY MR. O'DONNELL:

Q. Mr. Norman, will you please turn to page 5 of your statement, to the second paragraph where you refer to the tables appearing on page 11 of the Canadian National submission. You refer to that, and you go on to say:

> ". . . all of these estimates appear to assume it to be a foregone conclusion that revenues

will be reduced and at no time will there be an increase."

(Page 20740 follows)

Now, it would be fair, I assume, to place in juxtaposition the footnote which is found on page 11 of the Canadian National submission and which explains the purpose of the tables to which you refer. You will remember that the table is headed, "Estimated results at various levels of gross revenue."

THE CHAIRMAN: Are you referring to your brief?

MR. O'DONNELL: I referred to page 5 of Mr. Norman's statement where he makes reference to page 11 of our submission.

THE CHAIRMAN: The next reference is to what, to your brief?

MR. O'DONNELL: Our brief, page 11.

THE WITNESS: Mr. O'Donnell --

MR. O'DONNELL: Q. You had better wait a moment.

A. All right.

MR. O'DONNELL: I point, my lord, to the fact that these tables are headed, "Estimated results at various levels of gross revenue."

Q. I am about to suggest to you, Mr. Norman, that to have a proper understanding of the table in the reference which you make to it that it would be right to have in mind the sentence at the bottom of page 11 which reads:

> "The above table is, of course, statistical and is included only to demonstrate as forcefully as possible the drastic effect on net earnings of the Canadian National which will accompany a substantial decline in traffic volume."

In other words, purely illustrative?

A. I would agree with that except I think to make the record complete you should probably read into the record the preceding paragraph to the table.

Q. Yes.

[illegible]

[illegible]

[illegible]

A. I think if you started there and ended there it would be fitting.

MR. CARSON: What paragraph is that?

THE WITNESS: "Traffic volume carried by the system is directly reflected in its net earnings, and an increase in gross traffic could be expected to result in an improvement in net earnings."

THE CHAIRMAN: What page is that?

MR. O'DONNELL: Page 10.

THE WITNESS: "Similarly, a reduction in traffic would bring about a related deterioration in the financial results. Traffic volume is not expected to increase in the immediate future. On the contrary, the anticipated trend is downwards." I think if you take the whole thing --

MR. O'DONNELL: Q. That is a fact, is it not, that according to your knowledge there has been a sloughing off of traffic?

A. Traffic is down as far as I am advised in the last three months, but the dollar revenue is up.

Q. But you would not want your statement to be read as an indication by the Canadian National that there was never going to be any variation upwards, and that the table was not to be used exactly for the purpose which is stated, merely as statistical information for the purpose of illustration of the effect which a drop in traffic would have on the Canadian National as such?

A. I would agree with you that I did not intend to convey --

Q. I am sure you did not.

A. -- that they indicated that their traffic was going to drop down to $300 million.

Q. Please turn to page 6.

THE CHAIRMAN: Which page 6?

MR. O'DONNELL: Page 6 of Mr. Norman's statement.

Q. You refer there to the British Transport Commission. There are certain differences, are there not, in so far as the Canadian National is concerned which make it other than the situation which prevails with respect to the British Transport Commission? For instance, the British Transport Commission or the government of Great Britain is under obligation to pay the holders of these bonds?

A. That is correct.

Q. And in Canada the government owns the bonds?

A. That is correct.

Q. And the British situation was set up on the basis that these bonds of the British Transport Commission I have just referred to were delivered to the holders of the shares of the various railroad companies which were taken over by the British Government in pursuance of its nationalization policy?

A. That is right.

Q. And those roads when taken over were in a much different condition from the point of view of operating results and financial position than were the bankrupt roads which were amalgamated into the Canadian National System in 1923?

A. I have not made any comparison of that.

Q. The fact is there is that very considerable difference?

A. Yes, and of course they are very much older too.

Q. And they were going concerns the bonds of all of which were quoted on the exchanges, and they were being dealt in day in and day out? They were going concerns. They were not over-burdened with the heavy fixed interest

charges that the Canadian National had at its inception?

A. Of that I have no knowledge at all.

Q. You have no knowledge at all?

A. As to whether they were -- some were going concerns; they were all going concerns. I have no knowledge as to whether they were in a good financial position or whether they were not.

Q. In any event, there was no suggestion that as of the date they were taken over they were burdened with any very excessive and unjustified fixed interest charges?

A. I would assume that from the fact that the stocks and securities purchased by the government were valued at a certain given price on the exchange.

Q. On the exchange.

A. That is right; one would assume it.

Q. Now then, please turn to the last paragraph on page 10. You refer there to the $300 million which is represented as a part of Mr. Gordon's proposal?

A. Yes.

Q. And we should bear in mind that Mr. Gordon's proposal is that the overburden or excessive fixed charge interest-bearing debt of $1,500 million should be settled for $1,300 million roughly in round figures?

A. Well, I do not read into Mr. Gordon's suggestion that he has got an overburden of debt of $1,533 million.

Q. The fixed charge is excessive?

A. That the charges are excessive, yes.

Q. And he proposes to settle the whole thing on a compromise basis which would result in roughly a $1 billion adjustment, this proposal?

A. I do not understand -- what is he compromising?

Q. He is compromising the $1,544 million to roughly $1,060 million. Is that not a fair way of putting it

in your view?

A. I should like first of all to refer to what Mr. Gordon said.

Q. Read page 3 of your statement. You will see the proposals there.

A. It says this statement evidencing an excessive capital burden. He did not say that was the funded debt of $1,533 million, which is in excess of the fixed charge debt of $1,344 million. He does not say it is the fixed charge debt.

Q. That is right.

A. It is the excessive capital burden he is willing to compromise.

Q. He works it out at $1,544 million?

A. Yes.

Q. And the proposal is for $1,060 million, that it should be settled on the basis he sets out in his submission?

A. That is correct.

Q. Now, you refer at page 10 of your brief to a blanket appropriation,, and you have referred at the top of page 11 in the same paragraph to a hidden subsidy in the neighbourhood of $9 million. I am curious to know how that could be termed a hidden subsidy. I take it you have looked at Exhibit 245. That is the consolidated balance sheet as at December, 1948, giving effect to these adjustments. You will see clearly on the face of that balance sheet, as drafted by Mr. Cooper, the clear designation of the $300 million as being government of Canada capital funds receivable from?

A. Yes.

Q. You will see that is how he proposes the balance sheet should read, and that item would be there for all to look at it?

A. At that moment of time, but that $300 million disappears very rapidly as it is used.

Q. If it disappears it will be found somewhere else?

A. But not earmarked as such.

Q. I shall come to that. Then there is Exhibit 246 which is the net income results for the year 1949, and there again one would find interest on government indebtedness, $9 million, on the face of the statement?

A. That is right.

Q. Again I suggest there is not much hidden about that?

A No, but it will be hidden in due course of time as the $300 million is used.

Q. Your fear is that the accounting officers will be able to put it over the auditors, so to speak, so that the item will not appear?

A. No, I am not saying that at all. So long as the $300 million is owing your accounting officers will show there is $9 million of income received, but so long as it isn't owing they will not show it.

Q. And it will appear somewhere else by some other item?

A. No, it cannot appear somewhere else. It has disappeared; the income does not come in.

Q. If the proceeds be used for the acquisition of capital expenditures?

A. And there is no segregation of the income from that capital expenditure as such.

Q. But if any portion of the $300 million is used for the purpose of capital expenditure, and that is one of Mr. Gordon's proposals, do you suggest there would not be a clear record of that?

A. There would be a clear record of the expenditure but it will be merged in the mass of investments in railroad enterprises and not kept separately.

Q. Under the arrangement of the Canadian National, which you are aware of, thatwould only be after the budget had been submitted to parliament and approved by parliament?

A. I assume so.

Q. That is a fact each year?

A. Yes.

Q. That being the fact how can one suggest that there would be anything hidden in that?

A. That would simply be, as I understand it, in regard to the use of moneys for capital purposes. If you used those moneys for other purposes --

Q. If we used the money for paying off debt, for instance?

A. That would be automatically shown but it will not remain shown. It will be shown the first year it happens.

Q. I know, but on the other hand --

A. Memories are short.

Q. That may be but on the other hand theequity owners, the people of Canada, have that record, and it has been approved of by parliament. In the first instance if it be a capital expenditure, and by parliament's auditors if it be used for payment of debt?

A. And if it is used for expenses?

Q. If it is used for expenses -- where do you get any suggestion it would be used for expenses?

A. As I say, maintenance of the road would be

important, and I assume --

Q. But Mr. Gordon's proposal is not that it should be used for expenses, is it?

A. No, he proposes to use it for the two --

Q. Capital expenditure and payment of debt; those are the only two items?

A. That is correct.

Q. So that we can agree that in either or both of those instances it is all done in the open and in the clear?

A. So far as the expenditure is concerned but it still remains a hidden subsidy after you have spent the money.

Q. I am just interested to follow you on that. When you suggest a hidden subsidy --

THE CHAIRMAN: I think we should clear up a point. In Mr. Gordon's submission he says that the government should acknowledge an indebtedness to the Canadian National in the amount of $300 million to bear interest at 3 per cent until discharged. What does "until discharged" mean?

MR. O'DONNELL: Paid.

THE CHAIRMAN: He goes on to say:

"This would be set up in the accounts of Canadian National as a capital fund."

That is, the $300 million would be so set up?

MR. O'DONNELL: Yes.

THE CHAIRMAN: To be drawn on from time to time. You would draw on the $300 million from time to time?

MR. O'DONNELL: That is right.

THE CHAIRMAN: To retire interest-bearing obligations in the hands of the public.

MR. O'DONNELL: Right.

THE CHAIRMAN: Suppose you applied $50 million at some time to redeem bonds. What becomes of the $300 million?

MR. O'DONNELL: It is reduced pro tanto.

THE CHAIRMAN: What interest would you continue to receive?

MR. O'DONNELL: Three per cent on the balance.

THE CHAIRMAN: Only on the balance?

MR. O'DONNELL: Surely.

THE CHAIRMAN: I mention that because it is important. You have been talking to each other as if the 3 per cent on the $300 million might go on forever.

MR. O'DONNELL: That is the suggestion, and I say that is not accurate or correct.

MR. CARSON: I think if Mr. Norman is asked what he means by a hidden subsidy of $9 million he will say it is something entirely different.

THE CHAIRMAN: That may be, but that interest goes on decreasing as you use your capital fund.

MR. CARSON: Mr. Norman is not talking about the $9 million of interest as representing a hidden subsidy at all.

THE CHAIRMAN: But Mr. Norman does refer to a hidden subsidy of $9 million.

MR. CARSON: I want him to explain it.

MR. O'DONNELL: I am going to follow it up in my own way, and I would ask you to be patient with me. I have not put anything unfair to Mr. Norman. I have the greatest respect for him. He and I are old friends; we know each other.

MR. CARSON: That is fine. I have known you for a number of years too.

THE CHAIRMAN: Mr. O'Donnell, I should like to ask Mr. Norman to tell us now what he means by this $9 million. What do you call it?

MR. CARSON: A hidden subsidy.

(Page 20748 follows)

THE WITNESS: My lord, under the proposal, the suggestion is that $300 million of money be made available to the Canadian National which they can use for two purposes, a reduction of debt held by the public or for capital purposes; and that the Canadian National will give the government equity stock for it. If it was entirely used for the purpose of redeeming funded debt, then the Canadian National is relieved of earning 3 per cent on $ 300 million forever.

THE CHAIRMAN: Q. I see.

A. If it is used to purchase other assets, then it is not obligated to earn any return on those assets to meet $9 million worth of normal requirements which would be in the normal course.

Q. If you have it one way or the other, this socalled $300 million would mean a subsidy of $9 million?

A. That is my own view.

Q. All right.

MR. O'DONNELL: Is not the common use of the word "subsidy" intended to mean something for nothing?

A. Yes. That is right.

Q. Yes. When you settle a debt or an overcharge as in this case on the basis that Mr. Gordon suggests, compromising $1,544 million by $1,060 million possibly through an exchange of securities, $760 million of interesting bearing common equity stock and $300 million by way of capital funds, is there not a quid pro quo there?

A. I would like to ask first what is the debt?

THE CHAIRMAN: Who is the debtor and who is the creditor?

MR. O'DONNELL: The suggestion, my lord, in Mr. Gordon's statement that the Canadian National Railway system was set up with an excessive burden placed on it at its inception, that there was never any adjustment

made, and that it is high time that it should be made. He said that that existing overcharge on fixed interest debt is $1,544 million and he proposed that it should be settled on the basis of exchange of $760 million of interest bearing securities --

THE CHAIRMAN: That burden should be relieved to that extent?

MR. O'DONNELL: Yes. He proposes to settle it.

THE CHAIRMAN: You are calling it a debt.

MR. O'DONNELL: It is a burden. It is a charge. He proposes adjusting that burden in this particular way. In those circumstances I suggest to Mr. Norman this treatment of the matter entirely overlooks the purpose of the adjustment and that the adjustment is a settlement of this burden which has been hanging over or was imposed on the Canadian National through the years. I asked him then to say where anything in the nature of a hidden subsidy of $9 million exists in the light of the fact that all the dealings with the $9 million are dealt with out in the open with the approval of parliament and with the checks that parliament's auditors have on the accounts of the Canadian National; and that in those circumstances, with all that publicity, and with the whole thing being in the open, how it can be suggested there is anything hidden about it.

THE WITNESS: May I answer you in another way, Mr. O'Donnell and probably make it a little clearer?

MR. O'DONNELL: Q. All right.

A. If, as one would normally do in a commercial enterprise, you are going to get new money, you usually put it at the top of the heap and not at the bottom. But assuming that you do put it at the bottom, the investor that does put it at the bottom feels that he is entitled to some return on it having put it at the bottom; and we will fix the rate at

3 per cent which apparently has been used here. If the C.N.R. was obligated to pay $9 million a year their deficit would be $9 million if they had one, and their subsidy would be that much more. This has got lost.

Q. That is not all that has got lost, in my view. I say that the object of the proposal has got lost in the treatment that is being given to it by the Canadian Pacific Railway. My suggestion to you is that the object of the proposal is to adjust something which should have been adjusted years ago on the authority of various people whose point of view has been put on record here.

A. I understand.

Q. And that this is the time to do it; and that the way it is suggested it be done is as Mr. Gordon suggested it. I am merely suggesting to you that it is not a question of new money, as you just mentioned, but that it is an adjustment of an over-burden, of an old obligation which should have been disposed of year ago , which was not justified -- if we be right in our contention, it was not justified -- and should be settled. In that case we reduce the debt and the fixed interest obligation in the way that Mr. Gordon suggests. And I suggest that is what is being overlooked. It is not a matter of trying to find new money. It is a matter of trying to settle an old obligation.

A. Is this not new money

Q. Do you think it is?

A. I certainly think it is.

Q. If the premises be right that there was an over-burden to be determined of $1,544 million, do you agree that there should be some settlement, if we can justify it?

A. Some change in the capital structure. I agree

with you.

Q. If we change it by using that capital fund which is recorded in the accounts of the Canadian National and which has to be submitted to parliament and its auditors and which has to be approved in the first instance by parliament, there is not much hidden about that, is there?

A. No.

Q. Right.

A. I would say "at that time". But it gets lost.

Q. I am going to suggest that it cannot get lost. On page 10 you use the words "blanket appropriation".

A. That is right.

Q. Here is why I suggest there cannot be anything about getting lost. You know that each year, with respect to the capital expenditures, the Canadian National has to go to parliament with a capital budget?

A. That is true.

Q. So that every item of expenditure that will be made for any part of the payment there, or to provide that the $300 million fund would be used, would have to have been submitted to parliament?

A. Yes. But might I suggest that the acceptance of the suggestions as to what you are going to do, you are certainly going to have some capital available paid from funds you have got.

A. I am speaking of the $300 million that you considered. That is the second proposal. I suggested it was part of the entire scheme.

A. I know you did.

Q. With respect to the expenditure of $300 million or any part of, so far as capital expenditure is concerned, the Canadian National Railways - and I ask you to agree with me -- must go to parliament for a capital budget and

ask for parliament's approval?

A. That is my understanding.

Q. That being the case, how can there be any part of the $300 million lost so far as its being expended for capital expenditure is concerned?

A. I have never said it is lost. I have said it is lost as being identifiable, because it gets merged in the enterprise as a whole.

Q. Let us look into that. Each year you also know that the Canadian National capital budget having been approved, there is a record of it?

A. Yes.

Q. Anyone who is interested in the matter can find it. How can it be lost there?

A. It is not lost there.

Q. All right. That is all I have in mind.

A. It is not indicated on the balance sheet that comes out every year, with your assumption of the $2 billion or whatever the thing may be, that the $300 million is in there.

Q. It may not be on the balance sheet but it may be somewhere else. It is on public record.

A. I agree with you.

Q. Anyone who was interested would look for it, and if he was diligent he would undoubtedly find it.

A. There are very few taxpayers interested to that extent.

Q. But those people who are not interested are not the ones we are particularly worrying about at this stage.

A. I sometimes think those are the people who should be protected.

Q. They send their representatives to parliament under our democratic system, and those representatives know what is

going on, or presumably they do.

A. Presumably.

Q. Yes. Then just let us turn to page 12. There again I find at the bottom of the page, the third line from the bottom, the word subsidy". I think we have covered that aspect of it in questions I have put to you and I will not say anything about it, other than making the suggestion that there again, in your treatment, the purpose of Mr. Gordon's plan in his submission is entirely overlooked. The fact that it is an endeavour to adjust that over-burden is quite completely ignored by the Canadian Pacific treatment of the matter.

A. I would not agree to that at all. In these suggestions that are made here, my approach to it is that at some time or other after they have written off the things that do not exist --

Q. I am coming to that later. That is a few pages further on.

A. Then after that has been done, then so far as converting this into equity capital, it should be serviced to the extent that there is interest available for it.

Q. But you will agree with me that the principle is that in consideration of the setting up of the $300 million, the government gets equity stock?

A. Yes.

A. In other words, the government subscribes for stock?

A. Yes.

Q. Just as the C.P.R. shareholder subscribes for stock or buys it?

A. That is correct.

Q. And in those circumstances it is scarcely fair to suggest that it is a subsidy, in the common terminology of

the word ?

A. Except that under your C.N.R. Act, you do not have to pay dividends and you are not called up from the standpoint of borrowing, you do not have to do as the C.P.R. has to do. If you need more money, you do not have to do as the C.P.R. has to do, go out and get it in the open market.

Q. I am not speaking about that. I say that when a shareholder of the C.P.R. or a would-be shareholder subscribes for stock , he gets his stock against his money; and when the Canadian National suggests that the government subscribes for stock against some other consideration, it is not fair to designate those transactions as subsidies.

A. I think they are two entirely different matters.

Q. We will let it go at that.I suggest that they are somewhat parallel. In any event, will you please turn now to page 13, paragraph (c). There you say:

> "Counsel for C.N.R. has stated that the government railroad has not asked to be made the yardstick for rate making. It is my opinion, however, that some sections of the public will use any comparisons which appear to be favourable to them in either resisting an increase or clamoring for a reduction in rates and tolls."

There you are assessing what you think some section least of the public will do?

A. That is right.

Q. We will leave it at that. Is not that the purpose, Mr. Norman, for which the Board of transport has been set up, to see to it that there is a fairness between the public on the one hand --that is shippers, for instance -- and the railways on the other, and to see that despite the clamour for a reduction of rates possibly by the shipper or for an increase of rates by the railroads, or vice versa, to see that

what is just, fair and reasonable with regard to rates shall prevail. Is that not the purpose of the Board of Transport Commissioners?

MR. CARSON: I suggest to my friend that that is a matter that he and I, or that lawyers can argue out rather than the witness; that is, as to the purpose of setting up the Board of Transport of Commissioners under the Statute.

THE CHAIRMAN:Q.I think Mr. Norman, that you would understand that.

A. That is my general understanding. I have read the Act.

MR. O'DONNELL: Q. That is all I had in mind.

A. That is my general understanding.

Q. All during the years since 1903, when the Board was set up, this Board or the predecessor Board with a slightly different name has during the years since then, a matter of approximately 47 years, has done a fairly good job in the way of maintaining an even balance between the shippers and the railways.

A. I would not want to give my concurrence in that view, because I do not know.

Q. You do not know?

A. No.

THE CHAIRMAN: I suppose that any clamour that might come forward for a reduction would be addressed to that Board?

MR. O'DONNELL: Yes; and the Board has the ultimate right to say whether the clamour is well founded or unfounded.

THE CHAIRMAN: The Board would say that if the

C.N.R. is in fact earning these large surpluses, if it eventuates, that they are not going to fix any rates which would be hurtful to private enterprise, the Canadian Pacific.

MR. O'DONNELL: That is what I have in mind.

THE CHAIRMAN: That would be their answer.

MR. O'DONNELL: Yes, possibly.

Q. And if they have made a mistake, are you also aware, Mr. Norman, of the fact that there is an appeal to the Governor-in-Council as the Act presently stands?

A. Yes.

Q.. And that in turn or alternatively, there is in certain cases an appeal to the Supreme Court of Canada?

A. Yes.

THE CHAIRMAN: That is unquestionally the law.

MR. O'DONNELL: Yes.

Q. And on that basis during the years the railroads have been able to live. There has been a time lag in the last few years possibly in adjustments. I suggest it is too bad there should be that time lag but it is a passing matter, and we are entitled to presume that the Board is going to do its duty?

A. I would think so.

Q. My point is as to whether or not the suggestion her i n the C.P.R.'s submission is that the Board may not do its duty or will not do its duty.

A. No, not at all. In reply to that, I would also quote from the submission from the .C.N.R. which is quoted in my point (d).

Q. Yes?

A. The quotation is as follows:-

"In these circumstances lower freight rates following pressure for downward revision would probably have very considerably reduced if not entirely eliminated such surpluses."

Q. Yes. That is if it were justified.

A. That is not what they said.

Q. And if it were not justified, the rates would remain where they were; and if the rates should go up, the Board will say that they go up. Is that not a fair assumption?

A. Yes, if you get a proper measure; if you have a proper measure. I do not know that they will go up unless an application is made.

Q. You are not assuming that the alert operators of either the Canadian Pacific or the Canadian National will not in due circumstances file such application as may be necessary?

A. I cannot speak for the Canadian National, but I can assume that the Canadian Pacific will.

Q. You assume that down at Windsor Street things are done efficiently and quickly?

A. Yes.

Q. That is a fair assumption.

THE CHAIRMAN: The submission states:-

"In these circumstances lower freight rates following pressure for downward revision would probably have very considerably reduced if not entirely eliminated such surpluses."

What are the circumstances referred to when the phrase "in the circumstnnces" is used?

MR. O'DONNELL: That is referring to the boom years back in 1925 to 1929 I think. Mr. Norman refers

to that.

THE WITNESS: I think it referred to -- let me have the C.N.R. submission .

Q. You quote there from 1925 to 1929.

THE CHAIRMAN: As a matter of fact, would a downward revision which would eliminate your surplus entirely not have some effect on the Canadian Pacific?

MR. O'DONNELL: It would possibly. But if we had a surplus, they would have more surpluses. That is our theory.

THE CHAIRMAN: They would have greater surpluses?

MR. O'DONNELL: That is our position, owing to the low traffic densities and these various other differences in the operating positions between the two roads. That is the situation as we see it. That is why we have not the alarm that our friends have. We say that on the average we can expect to break even if we have these adjustments.

COMMISSIONER ANGUS: Yesterday there was an arrangement for a statement to be prepared, I think, showing what increase in freight rates would be necessary to give the Canadian Pacific . specific levels of income.

MR. O'DONNELL: You are referring to those two figures that Mr. Northey Jones used?

COMMISSIONER ANGUS: Yes

MR. O'DONNELL: I understand that our officers are checking the matter with the Canadian Pacific.

COMMISSIONER ANGUS: I was wondering if that could be advantageously carried one step further to show what income this level of freight rates would probably give to the C.N.R.

MR. O'DONNELL: I had that in mind.

THE CHAIRMAN: The C.N.R. as it is today?

COMMISSIONER ANGUS: Yes.

MR. O'DONNELL: No, the adjustment. I have that in mind. I think we will have evidence to that effect.

Q. Mr. Norman, would you please turn to page 15. There you set out an extract from the Duff Report?

A. Yes.

Q. That extract, generally, speaking, deals with the reckless competition that went on during the period that is referred to in the report?

A. That is correct.

Q. And as a result of the review of what happened then, the competition between the privately-owned road and the Government-owned road, the Commission blamed both for that unwarranted competition. You will remember that the Canadian National - Canadian Pacific Act was adopted following the Duff Report?

A. Yes.

Q. In the light of the amendment to the law which were provided by that Act, is there any doubt in you mind that the situation such as that referred to in the Duff Report, paragraph 114, could ever occur again?

A. Is there any question in my mind?

Q. Yes.

A. I think there is.

Q. Are you familiar with the provisionsin the Canadian National - Canadian Pacific Act?

A. No. I have not read them.

THE CHAIRMAN: Pardon me a moment. That Act was intended to bring about the situation that competition should give way in part at least to co-operation. That is the effect of it?

MR. O'DONNELL: Yes, section 17(3) of the Act reads as follows:-

"Without restricting the generality of the foregoing, the power and jurisdiction of the tribunals shall extend to disputes, as defined by this Act, relating to measures, plans and arrangements or proposals therefor which concern -

(a) Joint use of terminals;

(b) Running rights and joint use of tracks where there are actual or functional duplications, or where such may be avoided;

(c) Control and prohibition in respect of the construction of new lines and provision of facilities and additional services where no eseential need of the public is involved or where the result would be in the main the division of the traffic already adequately provided for."

(Page 20760 follows)

THE CHAIRMAN: Yes, but what has that to do with the present question?

MR. O'DONNELL: I am just asking Mr. Norman, if he thinks, in the light of that statute, which prohibits the reckless building of railroads with the only object of dividing the traffic, and where there is no essential need, whether that type of reckless building could happen again in Canada.

A. If the statute --

THE CHAIRMAN: Q. Mr. Norman, did you previously point out that there was a danger of the C.N.R. indulging in reckless building?

A. No, sir.

MR. O'DONNELL: Is that the inference, then --

THE CHAIRMAN: I had not understood that.

MR. O'DONNELL: I understand that.

Q. And is not the inference on page 15? You preface that extract from the Duff Report by saying:

> "I would refer to Section 114 of the Duff Report, 1931, which deals with the competitive aspect when one railroad is privately-owned and the other backed by the long purse of the State."

Then, after quoting the extract, the Canadian Pacific have put in these words:

> "It would be presumptuous for me to suggest that such a condition might reoccur were so large a sum to be at the disposal of the government-owned railway."

Is not the inference there, so far as our Canadian Pacific friends are concerned, that such competition, unwarranted, would again take place?

A. Well, my inference there, sir, is that conditions might easily arise where the Canadian National

would have funds to go ahead with capital expenditures of this character, when the Canadian Pacific would not be in that position because of the difficulties of raising money in difficult times.

Q. And is that not one of the purposes for which the Canadian National-Canadian Pacific Act was adopted, that there should be no unjustified competition of that kind?

A. Well, the question is, what do you mean by competition?

MR. EVANS: There is really a legal question there.

MR. O'DONNELL: Q. That is all right.

MR. EVANS: The purpose for which this Act was put into effect. Now, quite obviously it was never intended to deal with a situation where the Canadian National might have money to go ahead with development lines and the Canadian Pacific would not have money. How could anybody say that that was under that Act?

THE CHAIRMAN: It is of some importance. Does either of you gentlemen interpret that Act as carrying any restraint upon your building new lines or acquiring new lines?

MR. O'DONNELL: We do, yes, my lord.

MR. EVANS: I have no doubt that that would be intended to prevent a wholesale competition between two cmmpanies; but the point that is --

THE CHAIRMAN: That is, all kinds of competition, including the acquisition of new lines and the building of new lines.

MR. EVANS: I would think so. My point does not turn on that. My point turns on this, that the subject of discussion between counsel and witness is whether the Canadian National would be in a position where it will have

money to do all these things, and because the Canadian Pacific has no money there is no competition for the building. In fact the Canadian Pacific will not have the money if what we fear comes about, and therefore the preferred position is that of the Canadian National, and I say that is not a part of the purpose or the language of the Canadian National-Canadian Pacific Act.

MR. O'DONNELL: Part of the language of the Canadian National-Canadian Pacific Act is that where no essential need of the public is involved, or where the result would be in the main the division of traffic already adequately provided for, there cannot be this unwarranted competition, and there is that restraint on it provided by the Act.

THE CHAIRMAN: How do you go about the acquisition or the building of new lines?

MR. O'DONNELL: I am coming to that next, my lord.

THE CHAIRMAN: You must have certain authority.

MR. O'DONNELL: Yes.

Q. In addition to what one finds in the Canadian National-Canadian Pacific Act, even if the Canadian National had money, you are aware ofthe provision of Section 21 of the Canadian National Railways Act, which forces the Canadian National to get approval of the expenditure for the construction of any new lines, and that the Canadian National must go to parliament for approval?

A. That is correct.

Q. Now, in those circumstances, what danger is there there, with parliament controlling every mile of line that is built within the provision of those sections?

MR. EVANS: My friend is also again asking the witness what danger is there there. Now, I can tell my friend --

THE CHAIRMAN: That is an argument, I think.

MR. EVANS: Yes.

MR. O'DONNELL: The only reason I am doing it, my lord, isthis, that in this submission --

THE CHAIRMAN: Well, you can ask the witness whether or not he is aware that there are these restraints upon him.

MR. O'DONNELL: I have asked him that.

THE WITNESS: I do not know the Canadian National Railway Act. I do know that you go to parliament. I do not know anything about the terms of the Act.

MR. O'DONNELL: That is all I need. That suits me fine; and parliament is in control.

MR. EVANS: Under Section 21 there can be no doubt whatever that the Canadian National has a preferred position over the Canadian Pacific, because they have power to build branch lines that are found nowhere in our Act.

THE CHAIRMAN: Well, I have not Section 21 before me.

MR. O'DONNELL: I will read Section 21, my lord, if I may:

> "With the approval of the Governor in Council and upon any location sanctioned by the Minister of Railways and Canals the Company may from time to time construct and operate railway lines, branches and extensions, or railway facilities or properties of any description in respect to the construction whereof respectively, Parliament may hereafter authorize the necessary expenditure or the guarantee of an issue of the Company's securities."

Parliament is in control throughout.

MR. EVANS: We have no such powers.

MR. O'DONNELL: Well, it is too bad. You can

go to parliament and get an Act that gives you the same power.

THE CHAIRMAN: Anybody is free to go to parliament.

MR. O'DONNELL: Yes, including the Canadian Pacific.

MR. EVANS: We would have to get a statute to build a branch line over six miles in length. All my friend has to do is to put into his budget a provision, as he has argued, for the building of a branch line, and he gets his appropriation from parliament, he gets his location approved by Order in Council, and he can build a branch line. Now, we contend that that is a preferred position as it stands, and all I was objecting to was that he ought not to ask an accounting witness what are the legal consequences of Section 21 of the Canadian National Act.

COMMISSIONER INNIS: Are you putting in an amendment on that question, Mr. Evans?

MR. EVANS: No, sir.

MR. O'DONNELL: Now, is it not six of one or half a dozen --

THE CHAIRMAN: I had this in mind -- addressing myself not to you, Mr. Evans, but to Mr. O'Donnell -- it is by the machinery of that Section 21 that you acquire all the lines you have.

MR. O'DONNELL: No, not all, my lord, because you will remember the entrusting provision in Section 19. By my whole point about Section 21 is that, whether it be done in one way or done in another, in the final analysis --

THE CHAIRMAN: Give me an instance, perhaps, of some of the lines that you have acquired or built.

MR. O'DONNELL: Well, take the last line built by the Canadian National, the Barraute line; there was a statute. We have got to go and get the statute. My

friend says, "Well, you simply include the money in your capital budget." I say it is six of one and half a dozen of the other, because in the final analysis --

THE CHAIRMAN: What line did you say?

MR. O'DONNELL: The Barraute, my lord.

THE CHAIRMAN: Which is that? What province is it in?

MR. O'DONNELL: That is the last line that was built; it is in Quebec, in the northern mining area. It is on one of those exhibits.

THE CHAIRMAN: That is not one of these unremunerative lines that were forced on you?

MR. O'DONNELL: Well, that line was built as a development line, and it is hoped that ultimately it will be of some value, but my whole point is that before we could build that line we had to go to parliament, and under Section 21 we have to get the expenditure approved. Now, that being the case, what danger is there? -- because parliament, after all, is in control, and our friends are free to go there and have their representations made, either through members or in the committee, and they have done it, and do it constantly.

THE CHAIRMAN: How did you acquire the Temiscouata line, so I may have an instance?

MR. O'DONNELL: Well, as I remember it -- and the Order in Council is available -- the Temiscouata line was acquired by the government and turned over to the Canadian National --

THE CHAIRMAN: Simply entrusted to you by Order in Council.

MR. O'DONNELL: That is right.

THE CHAIRMAN: It has no particular statute?

MR. O'DONNELL: No, that is a different type of

thing. My point is, the suggestion that is contained in this C.P.R. submission as presented by Mr. Norman, on page 15, which indicates, or the implications of it are, that it would be very dangerous to adopt Mr. Gordon's submission, by reason of the fact that it might lead to unwarranted competition --

THE CHAIRMAN: Unwarranted competition in the acquisition or building of new lines.

MR. O'DONNELL: Yes.

THE CHAIRMAN: That is the kind.

MR. O'DONNELL: The building particularly is what they refer to in that paragraph 114, and I say since that report in paragraph 114 the Canadian National-Canadian Pacific Act was put on the statute books, and the fears of my friends are not warranted. I further point to the Canadian National Railways Act, and my friend says he does not like the provision of Section 21, that it provides something that the Canadian Pacific has not got, but I point to the fact that it has been on the statute books since 1919, and they have had plenty of time in the interval to have it amended if it were improper. And I say that under that Act, under that Section --

MR. EVANS: I did not say it was improper.

MR. O'DONNELL: Well, you complain that it is unfair to your line.

MR. EVANS: No. What I said was that they have an advantage under that Section as compared with the privately-owned company, and I rose primarily to suggest that it was a subject upon which Mr. Norman could hardly be expected to express an opinion.

MR. O'DONNELL: I did not ask him anything about that aspect of it. But if there is an advantage, I say to my friend it is only there because parliament put it

there, and it was put there thirty years ago.

THE CHAIRMAN: Well, you are answering by reference to these statutes, the statement on page 15.

MR. O'DONNELL: Yes, the inference.

THE CHAIRMAN: To what extent has Mr. Norman's evidence to do with it?

MR. O'DONNELL: Mr. Norman points to this main implication only; although he says it would be presumptuous for him to make a suggestion, the interpretation I say is none the less there, and I am just trying to brush the suggestion away.

THE CHAIRMAN: Well, we will take a few minutes now.

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(Recess)

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MR. EVANS: I made reference just before the intermission to the Canadian Pacific's power to build branch lines, and I think I was a little too sweeping in it. I want to be quite clear on just what those powers are.

THE CHAIRMAN: What are you reading from, Mr. Evans?

MR. EVANS: I am looking now at the contract which is appended to the statute under which the Canadian Pacific was incorporated in 1881, and under paragraph 14 of the contract, which is incorporated in the statute, the company shall have the right -- I am reading from the section -- from time to time to construct, equip, maintain and work branch lines of railway from any point or points along their main line.

THE CHAIRMAN: That is the point that I

remember; it must extend from your main line.

MR. EVNA:S Yes; and I do not want to be on the record as saying that we have no other powers than are given in the Railway Act.

THE CHAIRMAN: If you wish to do any building which does not touch your main line, then you have to go to parliament for special authority.

MR. EVANS: That is right.

MR. O'DONNELL: I would point out that we have to do the same thing, so in that respect we are pretty much the same. We have to get the moneys approved for expenditure.

Q. Now, Mr. Norman, will you please turn to page 16 of your submission?

A. Mr. O'Donnell, before leaving page 15, could I make a further statement with regard to my so-called inference?

Q. Yes, certainly.

A. I think that in Mr. Gordon's submission at page 18387 he states that this money is to be drawn on from time to time to retire interest-bearing obligations in the hands of the public or for capital additions to the property. He does not say for extension of lines or building branch lines. Now, I have expressed the fear here, and my fear is that in time of distress -- which may come;you never can tell -- if you are in a position of having available moneys you can make additions to properties, but not necessarily lines; you might order new diesel engines, you might add astral domes to the tops of your cars, and all sorts of things, which the C.P.R. having to go out in the open markets for their capital would not havethe funds necessary to do.

Q. That is what you have in mind?

A. That is what I have in mind.

Q. Then what I point out to you by way of meeting that fear or dispelling that fear is that the Canadian National even though it had moneys would have to go to parliament with a budget and have the approval of the expenditure made before it could be done; now, are you aware of that?

THE CHAIRMAN: Mr. O'Donnell, would that apply to all capital expenditures?

MR. O'DONNELL: Yes, my lord.

THE CHAIRMAN: All capital expenditures?

MR. O'DONNELL: Yes. If it is a railway line, Section 21 is there; if it is a capital expenditure, then there is Section 12 of the Canadian National-Canadian Pacific Act as amended by 1 Edward VIII, Section 25, which reads in part -- I might read the whole thing:

> "12. The annual budget of National Railways shall be under the control of the Board of Directors. Estimates of the amounts required for income deficits, for interest on obligations outstanding in the hands of the public, for capital expenditures and for refunding or retirement of maturing securities shall be submitted by the Board of Directors to the Minister of Transport for the consideration and approval ordisapproval inwhole or in part of the Governor in Council andthereafter presented to Parliament. Income deficits shall not be funded. Amounts provided by Parliament to meet capital expenditures shall not be diverted to cover deficits in operation unlesswith the express authority of Parliament."

Now, whatever it be, whether it be branchlines or astral domes or anything else, my submission, Mr.

Norman, is that there is no fear, inasmuch as the matter is wholly within the control of parliament, no expenditure can be made without the approval of parliament, and -- and we have told this Commission, your lordship will remember, that we have not asked to have those fetters taken off.

THE CHAIRMAN: That is to say, you are willing to take this $300 million fund subject --

MR. O'DONNELL: Treated just as the Acts which apply to us provide. In other words, we could not spend any portion of the $300 million underthat section of the Act which I have just read either for capital expenditure or retirement of securities or any other way without having had the budget approved by parliament. In those circumstances I cannot for the life of me see what the fear is.

THE WITNESS: Mr. O'Donnell, may I just go a little further?

MR. O'DONNELL: Q. Yes.

A. I admit that you have that control, but would not Parliament -- I do not know whether they would or they would not, but my fear is that Parliament still would be interested, whether you have got money, or whether you have not.

Q. Don't you think Parliament would have the interests ofthe Canadian Pacific Railway in mind at that time, and don't you think also that those very energetic gentlemen from Windsor Street would be there to see to it that their memories were joggedand that they did have it expressly in mind?

A. I would certainly hope so.

Q. Well, we have no doubt, have we? And the further thing is, so far as that $300,000,000 fund is concerned, until we get the money in hand, the government is holding

it, and we have got to get it from the Government, haven't we?

A. I understood they are going to put it on deposit.

Q. Now, just a minute - -

A. Acknowledge an indebtedness - the same thing as taking it.

Q. Let me refer you to Exhibit 245, where, on the face of the Balance Sheet it is shown, Government of Canada capital funds receivable from - it is merely a claim against the Government?

A. That is right.

Q. And therefore until paid the money is in the hands of the Government. It is a good claim, I agree with you.

A. Isn't it rather technical? I notice you put it in your current assets.

THE CHAIRMAN: That is to say, so far as this $300 million is concerned, suppose the Directors made up their minds to spend $15 million of it for certain capital purposes, they would then go and apply - -

MR. O'DONNELL: They have got to get approval.

THE CHAIRMAN: Instead of drawing upon it, as the language would seem to indicate, freely. Drawing upon it means going through all this procedure.

MR. O'DONNELL: That is right, my lord, because, coupled with the submission, your lordship will remember the statement I made to the Commission, that we were not asking to have the restraints or fetters - fetters was the word I used - which are upon the C nadian National and its expenditures, removed in any way.

THE CHAIRMAN: Although this $300 million is supposed to be a debt which the Government owes you for a certain amount of equity stock which you are going to give it.

MR. O'DONNELL: And it would become part - -

THE CHAIRMAN: You go so far as to call it a commensurate amount.

MR. O'DONNELL: Yes.

THE CHAIRMAN: Have you any figure in mind there?

MR. O'DINNELL: That is right, we say we will give them stock to the extent of the acknowledgment of the indebtedness, $300 million.

THE CHAIRMAN: And, that being the case, you do not intend the Act to be worded so that you can draw - -

MR. O'DONNELL: No, and we have not asked that, my lord, and I made the positive statement the other day that we had not asked for the withdrawal of any of those fetters, and I say those fetters were placed upon the Canadian National at the time when there was this terrific row between the privately-owned road and the nationally-owned road, and by reason of that competition which was so reckless on the part of both, and that those fetters were put on the Canadian National as a result of what had happened in the twenties, and we have not asked to have them taken off. We could not get any part of the $300,000,000 without having the approval of Parliament, we could not spend the money without the approval of Parliament, and surely, Parliament must , in the final analysis, be the judge of what is good orwhat is bad for all the railways.

THE CHAIRMAN: The only benefit that you could make use of without consulting Parliament would be the use of the interest.

MR. O'DONNELL: Well, there again we would have to get interest from the government; but we could not use the interest even --

THE CHAIRMAN: It is intended here that you could get it, because they owe it to you.

MR. O'DONNELL: That is right, but we could not use it again without having the capital expenditure approved.

THE CHAIRMAN: If it is for capital expenditure.

MR. O'DONNELL: Or for retirement of debt. We have got to have our budget checked by Parliament. There is a most complete fettering of the activities of the Canadian National on the statute books, as they stand today.

THE CHAIRMAN: Would you please, then, tell me for what purposes might you use this $9,000,000, without getting any authority for it?

MR. O'DONNELL: Well, this obligation, it is clearly said what it is to be for.

THE CHAIRMAN: What does it say?

MR. O'DONNELL: It is clearly said that it is to be for the retirement of interest-bearing debt obligations in the hands of the public, or for capital additions to the property.

THE CHAIRMAN: That is the $300,000,000?

MR. O'DONNELL: Yes.

THE CHAIRMAN: But in the meantime they pay you interest on it.

MR. O'DONNELL: Yes.

THE CHAIRMAN: On the unexpended remnant from time to time.

MR. O'DONNELL: Yes.

THE CHAIRMAN: Then in your expenditure of this

interest are you restricted in any way?

MR. O'DONNELL: We are restricted with respect to anything that falls within the provisions of that section of the Canadian National-Canadian Pacific Act that I have just read, and that is pretty broad. We have to make estimates of the amount required for income deficits, for interest on obligations outstanding in the hands of the public, or for capital expenditure or refunding or retiring maturing securities, and we have also to get approval ---

THE CHAIRMAN: That is all capital?

MR. O'DONNELL: That is right.

THE CHAIRMAN: But there are other monies that you expend ---

MR. O'DONNELL: I suppose we could take the monies into our till for operating expenses.

THE CHAIRMAN: There are monies you expend every day.

MR. O"DONNELL: Right; from current revenues, yes.

THE CHAIRMAN: Would this $9,000,000 go into that?

MR. O'DONNELL: I assume it would fall into the treasury, yes, to that extent, but I would just like to make this point, which possibly I did not make previously, and I think this is the crux of the whole thing: These submissions that have been placed before the Commission, I respectfully submit, and will argue later, blur what is really the proposal; they draw the main issue into a side alley, and try to leave it there. Now, what Mr. Gordon's proposal is is this -- and there are two parties involved in it, and the parties have been referred to this Commission for a dicsussion of the

problems, and for this Commission's recommendation as to its settlement. The problem is simply this: The Canadian National Railway says the government of Canada when it incorporated this railroad placed on it an unwarranted and unjustified burden of capital debt, and the Canadian National Railways as the recipient of the obligation says it has objected through the years to that debt, it hss never had an opportunity of discussing a settlement of it in any satisfactory way, and it has never in fact been adjusted, and the adjustment has been postponed and the discussion of the adjustment has been postponed. I said a moment ago the effect, as I view it, of the reference to this Commission is very clear, and that is, it shall review the capital structure of the Canadian National Railway Company and report on the advisability or otherwise of establishing and maintaining the fixed charges of that Company on a basis comparable to the other railways in North America. Now, this is the first real opportunity when any tribunal has had the duty of looking into the merits of that suggestion of the Canadian National Railway and determining whether it is right or wrong.

Now, Mr. Gordon says, as the creditor of the claim against the Government - he says and the railway say - "We have a claim of $1,533 million which is excessive capital burden and fixed interest debt which should be settled. It has been hanging there too long." Now, he further goes on to say - I am paraphrasing it, or putting it as I see it -"it is very difficult at this stage to analyze exactly mathematically and accurately what that claim should be settled for, I have looked into the thing with my officers and my Board , and we are

of the view that the whole thing could be settled and could be settled on a compromise basis, which would involve a payment so to speak of $1,060 million."

Now, the next thing is, how should the $1,060 million be paid? That is the whole thing. Mr. Gordon's proposal for the payment is, he says, "We will settle it on this basis, that you will exchange $760 million of interest-bearing obligations, promissory notes of the C nadian National Railway, which you have in your hands, at the present time, surrender those notes to the Canadian National Railways, they will issue to you stock of a commensurate amount, and further give us another note of yours, $300 million and we will call it a deal and settle it, and this contentious matter which has been there for years will be settled."

THE CHAIRMAN: Do you say issue more stock?

MR. O'DONNELL: Yes, we will issue them some more stock. We say, "Here, we cannot possibly, on the record, pay this interst. It is unwarranted, it is unfair. Everybody who has looked into it has so said." That is our version, and in the circumstances it should be settled, and we say that the amount is $1,544 million, which we will compromise, using the best judgment of officers versed in the operating figures and in the experience which that railway has had to operate under. We say, "If you will surrender the goods of ours against that" - it is all part of the proposal - "and give us another note of yours, which we will be entitled to ask you to pay us sometime at your convenience and at our need, and in the meantime you will pay us interest on your note, $300 million at 3% until we get the money," but even if and when we get the money, as I say, all those

safe guards against its expenditure which would so disrupt the operations of the other major road, on their pretention, are dispelled, in my view, because Parliament is in control of that matter from beginning to end , and it is only if Parliament wishes that harm should come that harm could come, and no one wants harm to come.

THE CHAIRMAN: Are you not asking, in effect - I am not saying you are not entitled to ask it, but so that we may grasp the situation better - are you not asking that the whole intention of the Canadian National Railway System should be changed? Apparently the Acts of Parliament are there to carry all these burdens - a whole lot of railways, some bankrupt and some unremunerative at the best. You were to be given the task of operating and running them. You are not expected to make them earn surpluses, I would say. Now you want all that radically changed, and henceforth you want your Company to be in the position where it is to run just about the same as a private company would run.

MR. O'DONNELL: Where at least it can hold its head up and get credit for the good job it does, and not have the sneer of the deficit each year thrown at it.

THE CHAIRMAN: If one looks at the Statutory intention of your Company, I do not think anyone need hang his head in shame. It is intended that you should carry these burdens, and you have carried them.

MR. O'DONNELL: Mr. Norman said there are too few people who understand - -

THE CHAIRMAN: I do not think there ought to be any feeling of that sort.

MR. O'DONNELL: That may be, but, as Mr. Norman said, people do not really know these things. I was

explaining to him, it was all in the open, there was nothing hidden.

THE CHAIRMAN: That is why I am mentioning it now. Now, you say for the future you would like your Company's position to be radically changed.

MR. O'DONNELL: No. What we are saying, my lord, is this - -

THE CHAIRMAN: And instead of being this bearer of burdens it should henceforth be in the position of a company which is intended to operate and make money. That is right, is it not?

MR. O'DONNELL: Well, not quite in that way, but in some part, yes. What we are saying is this,sir: We are saying that we were incorporated and these things were imposed on us.

THE CHAIRMAN: Well, imposed by Parliament.

MR. O'DONNELL: That is right, that is correct; but that they should have been - -

THE CHAIRMAN: The same Parliament which incorporated you passed these other Statutes which you say impose things on you; but that was the scheme.

MR. O'DONNELL: That may be, but on the other hand throughout the years we have protested against that, and we have said it was unfair, unjustified, and should be adjusted. Now, the other party to this - -

THE CHAIRMAN: That is to say, throughout the years you have been wanting to change your position.

MR. O'DONNELL: Wanting to get it on a proper basis; and we suggest that to be relieved of these fixed charge burdens and other things which have been thrown at us so to speak, andunder which we have struggled along for years, at this time. We say here

is the position, and we say our position is out of line with that of every othermajor railroad in the country and on the continent, and so on, and we say it should be adjusted, and we propose a scheme whereby it can be adjusted, and it is a relatively simple one.

THE CHAIRMAN: A scheme which wouldput your company on a new basis for the future.

MR. O'DONNELL: Well, it certainly would, as far as that is concerned, and we say it should be on a new basis.

COMMISSIONER ANGUS: The difficulty seems to be this, Mr. O'Donnell, that you have begun by saying that the burden is excessive if it consists of fixed charges which must be paid, and it seems to me you have assumed that it is also excessive if it consists of an obligation to earn something on equity capital. Now, those are two different propositions, and if your position is to be made comparable to that of other companies, isn't it a matter notso much of cancelling fixed charges and leaving nothing, as of removing fixed charges as such and leaving over some obligation to earn some return on equitystock? I will put it a little differently: the equity stock of the Canadian Pacific Railway is equity stock the interest payments on which are fixed as a requirement in fixing freight rates. The equity stock of the Canadian National Railways, as I understand it, is expected to remain an equity stock the return on which is not treated as a requirement in fixing freight rates and may even, as we have seen from some of the cross-examinations, be looked on as something of an abuse if it exists at all.

MR. O'DONNELL: Well, on the proposal that we have put forward, we say it is a conservative, modest one, and it has been suggested, I think even by you, Dr. Angus, that possibly we did not go far enough. On the other hand, we

put it as we see it on a conservative basis. We have not asked that the yardstick be changed; in other words, the C.P.R. is to be allowed to have what it needs -- we have not said they should not -- we say that if youadjust our set-up as is proposed on the judgment of I say the best qualified persons withthefullest detailed knowledge of the situation, to bring a considered judgment to the matter, we can hope to break about even. Now, doing that-, how arewe any menace to the Canadian Pacific Railway Company? We are no menace, in our respectful view, and we simply say that if you do what we ask you to do, you adjust us so that we are not obliged year in and year out to report, after a very excellent year's operating results, a deficit because of the fact that this heavy overcharge has been there since the inceptionof the company. That is all we are saying.

COMMISSIONER ANGUS: When you say, put things on a conservative basis, does that mean that you put the fixed charges as high as any that you expect to be able to meet? Is there not a danger of putting them too high?

MR. O'DONNELL: Mr. Cooper's evidence, I think, explains the situation there. Their appraisal of the thing was that on the earnings which this road could hope to have through the years the adjustment which is proposed is fair and reasonable, and will have the results which I have indicated and which he has testified to.

COMMISSIONER ANGUS: I asked you that question because, would not a commercial enterprise say that it had put its fixed charges on a conservative basis if it had put them so low that it felt quite certain it could always pay them?

MR. O'DONNELL: Well, there would not be any harm in doing that, Dr. Angus, because I think --

COMMISSIONER ANGUS: Is "conservative" being used in two opposite senses?

MR. O'DONNELL: I do not think so. I think the C.P.R. likes to keep its fixed charges as low as possible, and they do that so that if they happen to have a bad year the burden there is lighter than it would otherwise be. Now, the C.P.R's position, even if we both hit the same stormy weather as far as the transportation is concerned in any given year, is not in the same position as we are. We, with this fixed charge there, are obliged to report a deficit, but the C.P.R. is not; all the C.P.R. does is not declare a dividend, and not declaring a dividend is far less of a stigma in the view of the officers of our road than having to report a deficit. That is one of the considerations.

COMMISSIONER ANGUS: I quite agree with you on that, but is declaring a dividend as much a duty for you as it is for the C.P.R.?

MR. O'DONNELL: Well, earning a dividend is, if we can earn. But we have not asked for a change in the yardstick. What they get, what gives them what they need, we say we can carry on with, without being a menace to them, because we say that it will just allow us on this adjustment to break about even and in some years maybe to have a little, but in other years have a deficit. We do not anticipate any of these huge surpluses which, in my respectful view, are being drawn across the scenery here for the purpose of diverting the attention from the problem which really is the one that has to be faced, and that is the adjustment of the capital structure.

MR. EVANS: I do not know why my friend wants to

ascribe that kind of motive to me. I would not have thought he would. There is no attempt to draw a red herring across the trail. I think when we come to challenging motives, perhaps my friend ought to avoid that, because I think that if anybody has made his motives quite clear I have, and if I have not I hope somebody on the Commission will ask me questions designed to bring out what those motives are.

MR. O'DONNELL: Then I am quite willing to say that. My friend never has motives that are not proper ones, that is true, but my friend in effect with a proposal comes with something which in my interpretation of it has that effect: it diverts attention from the real problem, and the end result is the same. I know Mr. Evans never has motives that are not the most upright and worthy in every respect, but that these proposals or submissions may have the effect that I have indicated I think is true -- on my assessment of them, anyway.

COMMISSIONER INNIS: Q. Would you be content with the position that was set forth in the original submission?

A. Would I be --

Q. I mean, let us wipe out the proposal put forward by the President.

A. The original submission --

MR. O'DONNELL: That is, concerning surplus earnings?

COMMISSIONER INNIS: Concerning the whole system of accounting.

MR. EVANS: Wouldn't that be a question you should ask me, or the company?

COMMISSIONER INNIS: Well, I would rather ask you, if I may.

MR. EVANS: May I put it this way: Our brief was originally to the same effect, that we had no objection to a recapitalization so long as we had some assurance that we would have protection. I would be glad to read that section of the brief now. Our position is exactly the same. The only difference between what their original Canadian National proposal was and Mr. Gordon's statement is that they have now made clear what kind of recapitalization proposals they had in mind, although that was by no means clear in the brief.

COMMISSIONER INNIS: You regard them as all of one piece?

MR. EVANS: Well, I must say, to be perfectly frank, that I thought Mr. Gordon's statement went far beyond the implications of the original presentation.

COMMISSIONER INNIS: That is what I had thought.

MR. EVANS: I do not think there is any doubt about that.

MR. O'DONNELL: In your mind.

MR. EVANS: I am saying, I must say that is my view.

MR. O'DONNELL: You are suspicious, and you should not have been.

MR. EVANS: Perhaps my friend is wrong when he thinks I am merely suspicious, but I do say this, that our position in our original brief based on the original presentation of the Canadian National was as set out in page 109 of Part I of our brief, and that, in order to bring it back to the attention of the Commission, is contained in paragraphs 54 and 55. I need not read all of this, but the concluding sentence of paragraph 54 says:

"Nevertheless Canadian Pacific would be deeply concerned in any reduction in the fixed

charges of Canadian National unless the principle is recognized that Canadian National should be permitted to earn a reasonable return on a reasonable level of railway property investment."

Now, the concluding sentence of the next paragraph also illustrates it:

"A reduction in the amount of the fixed charges of Canadian National, unaccompanied by some statutory assurance that its permissible earning power as a railway would not thereby be reduced, would offer a serious threat to the ability of Canadian Pacific to continue to function as a privately-owned railway system."

Now, I think the answer must be that our position originally, even on what we thought were the implications of the Canadian National's proposal in its original brief, was that we should have some assurance of that kind, and it is perhaps fair to say that what has happened since has perhaps pointed up a little more specifically the problem that we saw in the original presentation.

COMMISSIONER INNIS: You would be happier with adherence to the original submission, but perhaps not content?

MR. EVANS: Well, happier in this sense, Dr. Innis, happier in that we did not think that the original submission would carry them quite as far: but we still have that problem, and I would still be arguing to this Commission that this relief or protection be provided.

COMMISSIONER ANGUS: Mr. O'Donnell, when you say that the Canadian National Railway is not asking to be made a yardstick, do you mean that you think that is a question that should be left to the free and unfettered discretion of the Board of Transport Commissioners, or do you mean that

it would be quite wrong to think of it --

MR. O'DONNELL: Well, my offhand reaction to that is that there is no reason for not having faith in the Board of Transport Commissioners, so far as seeing to it that all railways in Canada get a fair deal, and the shippers as well get a fair deal. That is our view, and we have not asked for any change in the Act accordingly.

COMMISSIONER ANGUS: You are not asking to be made a yardstick; do you also say you are not expecting to be made a yardstick?

MR. O'DONNELL: Well, not expecting to be made a yardstick -- I have no expectations whatsoever; that is correct. On the other hand, if the Board of Transport Commissioners felt that there should be some other way of adjusting rates than the present one, under the statute as it stands at the present time they have the right to do so. But we have said that the Canadian Pacific Railway should be kept in such a position that it can conduct its railway operations in an efficient manner; we have not said anything else. We say that competition is good, and that it is right that these two roads should be operating side by side, that it is healthy, and we have not for a moment suggested that they should not get what they are entitled to. The question of what they are entitled to is for the Board to determine, and we have not gone into that aspect of it. All we are trying to do here is to do a little adjusting in our own internal housekeeping -- that is all it amounts to -- and that we should be deprived of that right does not seem right to me, on the basis of fears which we say -- although we do not think it has any particular play in whether we are entitled to an adjustment or not here. We are entitled to what is right in our case, but we say the fears

are unfounded. That is our position.

Now, with respect to the original submission, I would like to draw the attention of the Commission to this, that the original submission, the Commission will remember, did promise something more to come, and particularly on page 72, under the heading "Summary", if the Commission would be good enough just to look at that, the Commission will see that the complete submission was not put there. We were studying a very difficult situation and very difficult and intricate problems, and we said so soon as we have those studies we will come along with the balance of the thing. At page 72 it reads , under the heading "Summary":

> "From the foregoing it will be apparent that further data will be offered at the hearings to show that the financial burden carried by the Canadian National as a result of the losses attendant upon the operation of these lines in the public interest is enormous and entirely beyond the earning power of the balance of the property. The burden can be likened to and for all practical purposes constitutes a constant or fixed charge additional to that created by the bonded indebtedness.
>
> "It is the opinion of the Management that the absorption in operating expenses of the cost of these non-paying public services should be recognized and action taken to relieve the Canadian National of the burden created by them. Studies to this end are being conducted and will be elaborated upon at the hearings."

Now, we only were able to deal with part of the problem at that time, by reason of the lack of information which

we needed.

COMMISSIONER ANGUS: You claim something entirely beyond your earning power, and yet do not tell us what your earning power ought to be.

MR. O'DONNELL: Well, we have told you what we expect, Dr. Angus, I think. We have told you what we expect we will receive, and we have produced exhibits. We have applied it to the 1949 results. You will remember Exhibit 246, Mr. Cooper's exhibit, where he shows the net income results for the year 1949, giving effect to these changes that he suggests, and he shows there we would have ended up with a surplus of $13,698,000, which is less, you will remember, than Mr. Northey Jones said he thought was something that might fairly be retained -- far less.

COMMISSIONER INNIS: Do you regard Mr. Gordon's presentation as a study?

MR. O'DONNELL: Well, he refers to the studies that have been made by the other officers. The whole thing is done piecemeal. He says, "I will have the senior officers who support these statements here available to give the information in the evidence." He did not have it in detail. But the whole thing is wrapped into one.

COMMISSIONER INNIS: I was trying to find out whether the Canadian National had any specific position or specific views prior to the coming of Mr. Gordon into the picture. Is there any sort of solid basis on which one can see through the whole position?

MR. O'DONNELL: Well, I think, Dr. Innis, that this submission which was filed in October, 1949, was before Mr. Gordon's coming, and the balance of the study and the over-all end result and the final judgment was made

by Mr. Gordon when he got there, because there had been a change in the personnel of the management at that time. But the whole thing was a running proposition and was in continuous study right through until it was finalized and submitted to the Commission.

COMMISSIONER INNIS: One does not feel very happy about having recommendations brought in by someone who was not familiar with the system, who comes in and proposes a result after say two or three months. One would feel much more certain about something which was developed after a longer time.

MR. O'DONNELL: Well, I would agree with that, Dr. Innis, if Mr. Gordon were all alone here and had just had two or three months' experience, but that is not the situation. The situation is, we have Mr. Fairweather and Mr. Cooper, who have been with the company for thirty or forty years, I suppose, and with predecessor companies, and the board of directors has been there for quite a long term of office, and all the other personnel who make the detailed studies which are collected together and screened, so to speak, by these top officers, who in turn report to the President, and he puts it to the Board. That is the way the thing has been done. It is not just the result of a study of a month or two, but it is as a result of the prior experience that these gentlemen have. I think we can assume that it is the combined result of the best judgment of the officers of the company, who have been with it for years and years and who know the system inside out, and it is their considered view which was submitted ultimately to top management and then to the Board, and was approved in toto by the Board.

MR. EVANS: Perhaps I should have made a

further reply to Dr. Innis on the difference between the original position and what I see in the new. Our original outline brief was made when we were in possession only of the Order in Council appointing the Commission, which indicated that it was one of the functions of the Commission to review the capital structure, but we also had this in mind, that the officers of the Canadian National in earlier proceedings before the House Committee and other places had discussed recapitalization in terms of income bonds, and I think that in that sense the implications which we drew from what might emerge as a proposal to the Canadian National related to what we then thought were their proposals; and to that extent these new proposals came as a very definite surprise to us.

MR. O'DONNELL: Well, that may be, but that, as Mr. Cooper said, may be the result possibly of a little new light on the matter. And, furthermore, I would say this: a lot of water has gone over the dam since the time referred to by my friend and when the proposals were discussed previously, and my impression is that they did not even then meet with the approval of the Canadian Pacific Railway Company, and through the years no proposal that in any way tended to relieve without very complete hedging about was ever expected to meet with the approval of the Canadian Pacific.

THE CHAIRMAN: Where were these proposals made?

MR. O'DONNELL: I think the proposal my friend refers to is a suggestion which was made in the Railway Committee of the House of Commons some time during the war -- 1946.

MR. CARSON: It is referred to in Mr. Norman's statement.

MR. O'DONNELL: That is right.

MR. CARSON: At page 19.

(Page 20795 follows)

MR. O'DONNELL: Yes. It is May 14, 1946.

That proposal, my lord and members of the commission, purported to deal only with a situation which then existed and it was merely part of a problem; but this is a larger problem and this is a submission that tends to settle the whole thing at that time.

THE CHAIRMAN: At page 19 I see the following:

" Even so, there may be some merit in the C.N.R. request that the total fixed charges be reduced in order to provide greater flexibility and to avoid deficits in periods of reduced traffic. In my opinion this might well be accomplished by converting the indebtedness to the government, which arose through the repatriation of British securities, to income bonds. This was proposed by Mr. Vaughan on behalf of the Canadian National before the House Committee on Railways and Shipping on May 14, 1946."

That is the proposal you mean?

MR. O'DONNELL: It is Mr. Evans who referred to it. I think that is the one he means.

MR. EVANS: Yes.

THE CHAIRMAN: Have you not just told us, Mr. O'Donnell that the C.P.R. opposes everything?

MR. O'DONNELL: My impression is that even that did not meet with their approval

THE CHAIRMAN: Is that so, Mr. Evans?

MR. EVANS: I know of no opposition but I cannot say there was none. I know of none. I will find out.

MR. O'DONNELL: My impression is that there was some because, it did not get much further than being put forward.

MR. EVANS: I think my friend is a little bit unfair when he suggests that we oppose everything.

MR. O'DONNELL: I will restrict it to this last thing. I do not think that last suggestion met with your approval and you say that you do not know there is no opposition to it, so we will leave it at that. It does not matter to me anyway. All I say is that as of May 14, 1946. Possibly my friend would like to settle on that basis today. But that day is gone, in my respectful submission, and the problem on the larger scale has to be dealt with; because at that time, by reason of the fact that there were in the hands of the government these repatriated securities --

THE CHAIRMAN: I must interrupt you, Mr. O'Donnell. We must adjourn a few minutes earlier than usual today, so we will adjourn right away .

MR. O'DONNELL : That is fine.

--The commission adjourned at 12.55 p.m. to meet again at 2.45 p.m.

(Page 20800 follows)

Ottawa, Ontario,

Wednesday, April 26, 1950

AFTERNOON SESSION

HENRY GORDON NORMAN, recalled

CROSS-EXAMINATION BY MR. O'DONNELL (Cont'd)

Q. Mr. Norman, just before turning to another part of your submission I would like to read this brief extract from the Order in Council setting up this Royal Commission -- it is P. C. 6033; and under 2(c), the Commissioners should in particular

> "Review the capital structure of the Canadian National Railway Company and report on the advisability, (or otherwise) of establishing and maintaining the fixed charges of that Company on a basis comparable to other major railways in North America."

With that in mind, Mr. Norman, will you please turn to page 16 of your submission. At the bottom of page 16, referring to those paragraphs numbered 1, 2, 3 and 4, over onto the next page, I take it that those are things, or relate to things, which you suggest or which you think you would want to have information about if you were considering this proposal of the Canadian National Railways?

A. That is correct.

Q. And I think we could agree that in order to proceed to get that type of information, some of it at least, it would require a considerable amount of delay, and it would require a considerable amount of study?

A. Yes, sir.

Q. And with respect to some part of it at least,

the closing part of the paragraph numbered one, the information regarding that part of the operation of the railroad system which would be distinguished from the portion which was being operated for national purposes -- that amounts to a segregation of that part of the thing?

A. That is correct.

Q. And in the light of the fact that the Government has expressed itself as being against the segregation of such operations, would that still in your view be a practical way of doing this thing or attempting to do it?

A. I think it would be a practical way for the purpose of making a suggestion as to what ought to be done.

Q. Notwithstanding the fact that evidently it is contrary to past Government policy, as I think you heard Mr. Fairweather say the other day, that in the case of the Newfoundland Railway that very thing had been suggested to the Government?

A. I have known government policies change.

Q. Oh, yes, but at the present time, as it is, your understanding is that it is against Government policy?

A. Correct.

Q. Now, with respect also to the fact that the Canadian National must be operated as a system, and the good and bad parts of it are all in together, do you see any real object in engaging upon such lengthy and detailed study as you suggest here?

A. Well, my feeling is, unless you do engage on these particular studies, it is a very difficult thing to valuate what is the earning power.

Q. Do you suggest that the valuation of the earning power as at this time has not been made by people who are very close to the operation?

A. As far as the future is concerned?

Q. As far as the past at least is concerned?

A. As far as the past is concerned --

Q. We have a complete record of that, haven't we?

A. And as far as the future is concerned, those who have made studies of the trends and who know the operation of the Canadian National have, I think we can agree, assessed their value of the future?

A. They have expressed views in generalities without translating them into figures, yes.

Q. Well, we will let the record speak for itself on that, and leave it to the Commission to appraise that; but in sum and substance, Mr. Norman, would, not or could not we agree that possibly you have suggested one method of handling the problem, as appears on page 16, and maybe Mr. Gordon's proposal and that of the C.N.R. is another method of handling the problem?

A. That is correct.

Q. And they might in the final analysis work out something that might not be too far apart, probably, after you had all the information?

A. I think that is quite possible.

Q. The matter, though, as I see it, is that with respect to yours,yourmanner of handling it, it involves a lot of delay and a lot of study in a detailed and specified way that can be disposed of possibly on the basis that Mr. Gordon has handled it, at this time, and without thatlong, lengthy time of delay?

A. Yes, but there has been a considerable period of time since the first submission was made. A lot of this work has been done.

Q. That is true. But some of these things might quite well run into a very long time. For instance, you say in paragraph No. 2:

"A sound appraisal of the earning power of the 'commercial' lines under conditions of stabilized costs and stabilized rates, that is to say after the imbalance between costs and rates has been corrected as nearly as possible."

A. That is right.

Q. When do yousuggestthat correction might take place?

A. Well, under that Iwas considering that you would take into consideration the present 20% application, of which you have already received 16 and are now asking for the other 4.

Q. And can't we agree that until the recent post-war conditions, when there has been a disturbance in rates and operating costs, wages and materials, we have the experience of operations for a considerable number of years under stabilized conditions?

A. Well, I would not say they were stabilized conditions.

Q. Well, relatively speaking.

A. During what period of time are you speaking of?

Q. We have the railroads operatingsince 1923.

A. Correct.

Q. Some portion of those twenty-seven years were disturbed; there were the depression years, for instance?

A. Yes, sir.

Q. And there were the war years?

A. And there were --

Q. The in between years?

A. The years when, as I understood from one of your witnesses, the period of time when you were going through rehabilitation.

THE CHAIRMAN: Q. Would you please repeat that?

A. The period of time during which they were going through a period of rehabilitation.

MR. O'DONNELL: Q. That is right; and at this point can we agree that in large measure the system has been consolidated and integrated in a fashion that would give us --

THE CHAIRMAN: Q. Pardon me. This last period of time to which you refer is not since the war, is it?

A. No; this was the period, sir, from 1923, for the first period. I think they mentioned either eight or ten years.

MR. O'DONNELL: Q. You, I am sure, have read the 21 per cent judgment at some time or other, and you remember the comment made therein, that the Canadian National Railways at this period is well integrated and has a high standard in service and operating efficiency; you remember that comment?

A. Yes.

Q. And the further comment which the Chief Commissioner made, which will be found at page 35 of the judgment, where he says:

> "The situation in respect to Canadian National Railways is quite different today to the situation prevailing in 1920 or even in 1926. The Railways are now fully integrated into one great railway transportation system which is well and efficiently operated and managed,"

and so on. Now, in the light of that and other extracts which I won't bother reading to you, we can agree -- at least, the Board has come to the conclusion that the Canadian National is well integrated and properly operated

at the present time, and, that being the case, are you so definitely of the view that this problem could not be handled until these additional studies that you suggest could be made?

A. I am not saying as to "they cannot be handled." I am saying that if the problem were given to me these would be the things I would want to know.

Q. That is the way you would do it?

A. That is my view.

Q. But you do not say somebody else might not do it in another way with equally beneficial results?

A. That is probably true.

Q. And there may be a shorter way of doing it than the way you suggest?

A. There are all kinds of ways of approach to a problem of recapitalization.

Q. That is right.

Now, my lord, I had other questions, but it occurred to me that maybe Mr. Norman has already answered some of them, at least inferentially. In any event, in my respectful view, much of the submission is argument, and, going on your lordship's suggestion the other day that the best way to deal with argument was in argument, I shall handle it that way and, save in so far as there may be something which I would like to have clarified through evidence, I will not ask Mr. Norman any more questions.

I thank you very much, Mr. Norman.

THE CHAIRMAN: Has anything been said yet, Mr. O'Donnell, on what you might call the problem, which is to establish and maintain the fixed charges of your company on a basis comparable to other major railways in North America? I wonder whether Mr. Norman addressed his study

to that basis.

Q. Did you, Mr. Norman?

A. My lord, I addressed my study, ratherthan to the standards of the whole of North America, to the position as between the Canadian Pacific and the Canadian National.

Q. Yes, I assumed that. And I suppose, then, that you were interested in establishing a proceeding which could bring about some benefit to the Canadian National and its attempted recapitalization without injuring the Canadian Pacific Railway?

A. That is correct, my lord.

MR. O'DONNELL: That is without fears which you think may flow from an adjustment.

THE WITNESS: Yes.

MR. O'DONNELLL: Thank you very much, Mr. Norman.

THE CHAIRMAN: Well, I think that is all, Mr. Norman.

MR. CARSON: I have just one or two questions, my lord.

RE-EXAMINATION BY MR. CARSON:

Q. Mr. Norman, at page 20662 Mr. Covert I think was asking you some questions about one of the paragraphs on page 11 of your statement, having to do with future development lines and the two categories into which you put these projects. One was, those which are fully justified from a commercial viewpoint and which may be expected to add earning power and therefore represent in whole or in part real additions to the Canadian National equipment and roadway property; and the second category was, those which are not justified from a commercial viewpoint but which are undertaken solely as a matter of national policy. Then Mr. Covert wanted to find out who

would decide whether it is a commercial proposition and whether you thought the Canadian National directors should have the decision -- perhaps not a decision, but the right to decide whether or not they will operate a line on a particular basis. And at the top of page 20663 you answered:

> "Well, I would think first of all that that would have to be in some degree measured by whether or not they got direction from the Government in the first place. If they get direction from the Government, then I would imagine that their statistical section and their engineers and other appropriate people will figure out whether or no it is of commercial value or whether it is purely of national value, and I think they must be the final deciders as to whether it does have commercial value or not."

I was wondering whether you had anyview as to what should be done in the event of the Canadian National directors and the Government having some difference of opinion on that issue. Have you any suggestion to make to the Commission as to who might decide it if there was a difference of opinion?

A. Well, if there would be a difference of opinion between the Canadian Government and the Canadian National I would think that the appropriate body to make a final decision in that matter would be the Board of Transport Commissioners, who are fully conversant with all matters pertaining to railroad affairs in this country.

Q. Then on page 20669 --

COMMISSIONER INNIS: Q. You are not placing the Board of Transport Commissioners above Parliament?

A. Oh, no. You see, if there is a difference of opinion and if they wish to refer it to another body -- after all, Parliament can say don't or do, but if they are willing to agree that there is a possible difference of opinion which could be resolved, then I would think the appropriate body to resolve that would be the Board of Transport Commissioners.

COMMISSIONER INNIS: Very dangerous to allow the Board of Transport Commissioners to encroach on the position of Parliament in the matter of budget expenditures particularly.

THE CHAIRMAN: Are you classing that as something that ought to be --

MR. CARSON: Oh, no, my lord; I was just wondering if he had any view as to who would make the decision if there was a difference of opinion, without any attempt to override the supremacy of Parliament. We all recognize that they are supreme and can lay down the law, but if Parliament said, "Now, we have this view," and the Canadian National directors come along and say, "We have quite a different view," I was wondering if Mr. Norman had any suggestion as to a tribunal to which Parliament might refer that difference of opinion. I am not suggesting at all, of course, that Parliament is not supreme and that the Board of Transport Commissioners would have power to override it. It is only if the Board of Transport Commissioners were invited by Parliament to give them their opinion on whether this particular line was one which fell within one category or another.

MR. O'DONNELL: The short answer at the present time is that Parliament would not give the money. That is the simple answer to it. Parliament controls that.

THE CHAIRMAN: Parliament might withhold the money

asked for until somebody, the Board or somebody else, had reported whether or not the line should be considered to be necessary. Such a thing, of course, is possible.

MR. CARSON: Now, at page 20669 --

THE CHAIRMAN: The distinction of course is this: Parliament is not bound to act on anything of that sort.

MR. CARSON: Oh, no, my lord.

Q. At page 20669, at the bottom of that page Mr. Covert directed your attention to a passage on page 14 of your statement, reading as follows:

> "These points lead one to the conclusion that the basis for rate making should be laid down by law as a reasonable return on a proper determination of property investment used and necessary to give the transportation service demanded by the public."

Then he said:

> "Now, I wanted to know first if you are suggesting there that a valuation should be made to determine a rate base for both railways?
>
> A. Yes."

Now, what did you mean as to valuation, Mr. Norman?

A. I did not intend to convey that in any way I was suggesting a physical appraisal of the property, as a valuation of the properties so physically appraised. So far as the C.P.R. is concerned -- and I imagine the same is the condition with the Canadian National -- those accounts are sufficiently indicative of the cost and the provision for depreciation of the properties which they are presently operating, and I would say that any body could be satisfied with an amount taken from those figures which would be acceptable to them.

Q. That is, to go to the books of the company

and determine --

A. To go to the books of the company to determine it, yes.

COMMISSIONER INNIS: Q. Mr. Norman, how do you get over the difficulty which must arise? Costs will differ at various periods depending on when the various items are being purchased: that is to say, prices will rise and fall. Is there not always the danger in this valuation of having the sort of dead hand of past prices hang over the rate structure?

A. Well, sir, on this basis your costs are always going to be lower. The cost as carried on the books of account of the average railway company, certainly as far as these two are concerned, must be lower than the present replacement cost, which I never would suggest as a basis, and also would be lower than actual factual cost, on account of the use of renewal method of accounting during certain periodsof their activities.

Q. Yes, I appreciate that. On the other hand, you are using a sort of structure which belongs to the past, in which much has occurred and of which much perhaps is irrelevant?

A. Possibly, sir, one might take this into consideration, that in arriving at the future one realizes that when one comes to replace,the replacement costs are going to be very substantially higher, and therefore some provision would have to be made for that condition. As to what they relatively are, you would have to go clear back to 1867, which would be almost an impossible approach.

MR. CARSON: It may well be, sir, and what you put to Mr. Norman might have to be taken into account in the rate of return that was regarded as fair.

MR. EVANS: Perhaps I can add this: Dr. Dorau had an

exhibit in the 20% case that valued in terms of present-day purchasing power -- that was in 1947 -- each dollar of increment of Canadian Pacific capital, and he produced in dollars of present-day value what the present historical or investment dollar cost would represent; and he got on that exhibit, according to my recollection, about $1.8 billion as the present-day dollar cost of the Canadian Pacific investment. He did that as a matter of trying to meet that same problem, I think, that you have in mind.

MR. MacPHERSON: I think, Mr. Chairman, that that introduces the question of rate base and the question of 49-49 again, and the question of reproduction cost that is being suggested by Mr. Carson in his last question to the witness, all of which is a new issue in a sense that has not been dealt with by the various witnesses --

MR. CARSON: I did not intend to suggest, and I do not think the Board interpreted me as suggesting, reproduction costs. That is the very thing I was putting to Mr. Norman to have cleared up.

MR. MacPHERSON: I submit my friend did, when in referring to Dr. Innis' question he said that that was a matter that could be taken into consideration by the Board in fixing the rate of return.

MR. CARSON: I shall let the record speak for itself.

Q. Then, Mr. Norman, one last question, in which Mr. Frawley got you yesterday to think a little bit about the people of Canada. On page 20706 he put this question:

"The last requirements presented to the regulatory body was $52 million, but by applying a rate of return to a rate base it comes out at $66 million. I simply put it to you as a citizen of this Canada of ours with some knowledge of

the trend of public opinion, do you think that would be satisfactory to the people of Canada?

A. No, I do not think it would."

What did you mean by that?

A. My intention was to convey the fact that I do not know of anyone in Canada who is at any time anxious for higher prices of any goods, commodity or use of anything, and they naturally are resistant and they are an unpopular thing.

Q. I think we have seen some evidence of that.

COMMISSIONER INNIS: Q. You mean higher prices or higher costs?

A. Yes.

Q. I thought everybody wanted higher prices.

A. Higher prices from the sales angle, but not from the consumer's angle.

MR. CARSON: I think we might close on that note, Mr. Norman.

THE CHAIRMAN: Well, thank you, Mr. Norman.

MR. CARSON: Mr. Elliott. He is a consulting economist and financial adviser practising in the city of Toronto.

THE CHAIRMAN: Of the Canadian Pacific?

MR. CARSON: Oh, no; he is in private practice.

COURTLAND ELLIOTT, called

EXAMINATION BY MR. CARSON:

Q. Now, Mr. Elliott, in your case, as in the case of the two witnesses who preceded you, your views and your qualifications are set forth in a written statement, copies of which were furnished some days ago to counsel for the Canadian National, for the Commission and for the provinces, and I would ask you just to be good enough to read the statement as you have prepared it.

A. Mr. Chairman and Commissioners: My name is Courtland Elliott and I am now practising as a consulting economist and financial adviser in Toronto. I graduated in 1919 from Queen's University in Kingston, Ontario, with a Master of Arts degree in political science and economics. From 1919 to 1921 I was a lecturer in economics at the University of Saskatchewan. Subsequently, I pursued post-graduate studies at the University of Paris, France, and at the Robert Brookings Graduate School in Washington, D.C. In 1927, I was relieving professor of the Department of Economics at the University of Saskatchewan. I was also a member of the division of research and statistics of the Federal Reserve Board, Washington, D.C., engaging in special research projects in 1926. I am also the co-author of the Elliott-Walker report on the social, economic and fiscal position of Alberta which was published in 1936. In addition, I am the author of numerous chapters in the economic publications of the University of Toronto and the Canadian Institute of International Affairs. I became originally associated with the investment dealing firm of A.E. Ames & Co. Limited in 1923 and continued this association, latterly as director and economist, until 1949. I was appointed economic adviser and later a member of the Board of Referees under the Excess Profits Tax Act from 1940 to 1946. I am now engaged in private practice in Toronto, Ontario.

Q. I suppose in the six year period in Ottawa, in connection with the Board of Referees, you had occasion to sit in judgment upon a great many Chartered Accountants and to weigh the arguments of members of the legal profession.

A. It can be so expressed.

The Canadian Pacific Railway has requested me to examine the recapitalization plan advanced by the Canadian National Railways and to peruse the evidence given before your Commission in connection with that plan. This request was made with a view to placing before you whatever comments I might develop, not as an expert in railway finance or operations, but rather as an outside observer with a detached approach to the subject at hand.

I have read with the utmost interest the evidence to date. There have been allusions to some aspects of the proposals that, from my point of view, are of vital and practical importance. With your permission, therefore, I would like to lay before you some consideration of the sequence of principles and policies which, in my mind, are inescapably involved in the recapitalization proposals.

The first question that occurs to me is as to the mental attitude that should be brought to bear in approaching the problem. Over the past quarter-century, as is well known, there has been developing a sharper division in the public attitude towards business operations. The differences between the advocates of public versus private ownership of business enterprises seem to be widening just as are those of the collectivists on the one hand and the capitalists on the other. I believe that recognition of this cleavage is important in approaching the recapitalization proposals because some advocates seem to attribute special virtues to public ownership and the initial conclusion might be lightly reached by the public that the proposals would be a boon to the taxpayers of this country, and that they should, therefore, command universal support.

I submit, however, that it is of vital importance to

know whether the proposals involve any increases in the burden of taxpayers or any shifting of the burden from the customers of the railways to the taxpayers, and of course every citizen, whether he realizes it or not, is a taxpayer. The customers of the railways and the taxpayers are primary parties involved no less than the creditors and owners of the railways. It seems to me that, over and beyond the accounting and financial intricacies involved, there should be a clear perception of who is now bearing and who is going to bear the costs of railway transportation in this country.

The fact is that the economic costs of providing rail transportation are in reality not altered by reason of the type of corporate organization that has to sustain them. In other words, the physical costs of railway operation are not substantially changed whether they are met by private enterprise or by public authority. The supply of labour, the provision of materials and other constitutents of railway operation are basic necessities for transportation requirements. They have to be supplied and paid for irrespective of whether the railway is operated by a private company or a government agency. In brief, in my view, recapitalization does not alter in any way the economic costs of railway operation because those costs are not a function of the capitalization.

It is true that the economic costs of railway operation may vary, as between two lines, because of differences in labour productivity, in accessibility of materials, in types of equipment used, in the topography of the territory traversed, in the density of traffic and, above all, in the skill of management in combining the elements of railway operation. Nevertheless, since certain basic economic costs must be sustained in any

event, I think it is reasonable to say that they will not be substantially changed whether they are met by private ownership or by public authority.

When this fundamental economic fact is translated into financial terms, however, its meaning frequently becomes obscure and confused. It is sometimes expected that, by some form of financial re-arrangement or public ownership, the real economic burden of operations can be reduced. But since the relatively inflexible physical costs have to be met in any case I suggest that financial re-arrangements may merely have the effect of shifting the residual burden as between the only two sections of the community who can currently sustain it. They are the customers of the railways on the one hand and the general body of taxpayers on the other.

The financial implications of this concept of economic costs are very real. In the case of publicly-owned railways deficiencies in traffic revenues can be quickly corrected only by prompt and adequate rate increases or, failing that, by recourse to the public treasury, the latter, of course, being a shifting of the burden to the general body of taxpayers. If the same contingency arises in the case of a private company, and is not corrected by prompt and adequate rate increases, it ultimately leads to bankruptcy proceedings with resultant losses to the saving classes of the community and eventually can lead to the Government taking over the railway and the assumption of new burdens by the taxpayers of the country.

It is important to note, however, that such financail re-arrangements do not dissolve the economic burden of continued operations. They merely shift it from customers to taxpayers where in my opinion, it does not

belong.

It is against this background, I think, that the validity of the recapitalization proposals of the Canadian National Railways should be judged.

In this connection I think that it is only natural that any business man, whether he is administering a public or a private enterprise, should strive for a "clean" balance sheet and self-supporting operations. I think it is equally true in the case of a public enterprise that the business revenues should support their total costs and, until this result is achieved, resort to recapitalization as a means of not reflecting deficits or depriving taxpayers of a possible return on their investment in a public enterprise should certainly be delayed or avoided.

The criteria for acceptance, modification or rejection of the recapitalization plan, it seems to me, fall squarely on three points, viz., (1) whether the case for recapitalization is justified by disproportionately burdensome financial charges that give little promise of being lightened by correction of the present imbalance between revenues and costs and by the possible growth in traffic itself, (2) whether it tends to shift directly or indirectly any additional burdens to the taxpayers of Canada and (3) whether it retains fair competitive standards of operation and finance as between the two transcontinental railways.

On the basis of the information available there is a considerable area of doubt in my mind whether the specific difficulties cited by the Canadian National Railways are basically due its disproportionate amount of funded debt and to a large amount of unremunerative investment. This position could take on a different

color if there were recognition that after every war the imbalance between prices and costs must be corrected and also if the possibilities of secular growth in traffic were more firmly emphasized.

In other words, even if the difficulties of the present are admitted and assuming the continuance of good management and correction of the imbalance, it is surely not beyond the bounds of possibility in a country such as Canada that the Canadian National Railways will be able to carry its debt, both through expansion of traffic as the country matures and through technological economies of operation.

I have raised these doubts that are in my own mind first, because the predicament of the Canadian National Railways may not be so serious or so permanent as is contended and, secondly, because it would seem to me that any important recapitalization should await the correction of the imbalance which, after every war inflation, is primarily responsible for inadequate revenues. In my view a recapitalization is not prescribed in these circumstances and should not be considered until the imbalance is removed.

If, on the other hand, the Government of Canada should be asked, in effect, to restate its losses and advances by the exchange of Canadian National Railways obligations for a form of equity capital, it is only fair and just to recognize that more than mere bookkeeping entries are involved and that the weight of debt should not be removed until every effort has been made to carry it and support it.

Moreover, I think that every effort should be made to draw a clear distinction between the position of government enterprise with its access to treasury

financial support and guarantees and that of a private enterprise which must rely upon much more fickle sources of financial savings for its capital requirements. In reaching a decision as to the validity of the recapitalization plan it is important that the weight of the fixed charges of the Canadian National Railways be fairly compared with, not only the fixed charges of the Canadian Pacific Railway, but also with the latter's income tax requirements and its preferred and common stock dividend requirements which are essential to keep open the channels to private investment capital.

If on these bases and contingent upon the removal of the imbalance between rates and costs it can be demonstrated that the Canadian National is undulyburdened with unproductive debt and onerous fixed charges, the exchange of whatever justifiable part of $760,000,000 of government-held obligations for equity of another form could be contemplated.

To follow the argument that, in addition, the System has a negative capital of $300,000,000 is to me exceedingly difficult. The suggestion is made that the Government should, added to the concession of as much as $760,000,000 mentioned above, acknowledge an indebtedness of $300,000,000 to bear interest at 3% per annum until discharged, thereby in effect still further reducing fixed charges by $9,000,000 per annum. As I understand the proposal, -- possibly I should say now, in view of this morning's discussion, as I understood the proposal ---- this fund would be beyond the control of Parliament and would be drawn upon from time to time to retire publicly-owned indebtedness or for capital additions to the property. It is difficult for me to be impressed by the logic or the reason for the suggestion that $300,000,000

plus interest at 3% be placed at the disposal of the Canadian National for these purposes. The contention is that the Canadian National has been the involuntary victim of unproductive mileage and mistakes in the past and it should not only be relieved from the consequences by the cancellation of all its fixed obligations to the government, but that in addition, the Government in turn shall obligate itself to the Canadian National for a further $300,000,000 to enable the Canadian National to improve still further its position. This is surely on the face of it a most unusual proposal which will bear the closest scrutiny. Few large businesses are in the happy position where all their operations are uniformly profitable and certainly such business are obliged to offset their losses against profits without any such form of financial aid.

There is only one other observation I would like to make. I have taken the position before this Royal Commission that if, after correction of the imbalance between rates and costs, the Canadian National Railways can justify a realistic recapitalization of a portion of $760,000,000 by reference to commercial standards and without a further shifting of burdens to Canadian taxpayers the granting of this concession might then be contemplated. To consider it now, is in my opinion, entirely premature in the light of possible economic developments.

There is the corollary, however, that the improvement of the balance sheet on a commercial basis and the relief from fixed charges entails a recasting of the income account on a similar basis. It would seem to me to be obvious that the Government of Canada, which, in effect, means the taxpayers of Canada, should not deprive

itself of any possible benefits of its concessions to the Canadian National Railways.

Oppressed by the burdens of the past and by doubts as to the future there may be a present temptation to minimize the earning potential of the Canadian National Railways and to assume that it will never achieve worthwhile surplus earnings to which the Government of Canada should have legitimate access. That, in my opinion, is a short-term assumption which is surely refuted by the growth of our population, wealth and income during the past half-century.

The potential earning power of the vast Canadian National Railway System allocated according to ordinary commercial accounting standards as well as the maintenance of the competitive position and financial integrity of the Canadian Pacific Railway call for a far-sighted and just disposition of surplus income after payment of fixed charges.

Prima facie it seems to me that, in return for recapitalization concessions, the Government of Canada would have every right to expect tow types of reimbursement out of any surplus operating income of the Canadian National Railways that might arise after the imbalance between rates and costs is corrected. In the first place, in the interest of removing discrimination between the public and the private railways, I am of the opinion that the Canadian National Railways should be obliged to pay an annual franchise tax, when earned, computed on an income tax basis. Moreover, instead of accepting any portion of $760,000,000 in equity stock the Government would seem to be entitled to an equivalent amount of income bonds, the interest on which would be payable only when earned. Moreover, it should not be

overlooked that the Canadian National Railways' balance sheet shows that the $760,000,000 of indebtedness is not the only financial interest of the Government of Canada in the railway. In addition the Government already holds $774,000,000 of equity stock whose claims upon any future bountiful earning power of the Canadian National Railways as the country grows should not be lightly dismissed. If, on these bases, the Canadian National Railways should become self-supporting then, as in ordinary commercial practice, surplus earnings over and above these requirements would be used at the discretion of the Board of Directors of the Canadian National Railways. Having regard to the fact that irrespective of whether railways are publicly or privately owned, their economic costs must be met, my view is that the new financial proposals must be carefully scrutinized to make certain that the burden is not being shifted to the taxpayer either directly by financial re-arrangements or indirectly by measures that would ultimately cause the Canadian Pacific Railway to become a public charge.

The gravest danger is that, after correcting the imbalance between rates and costs and after accepting losses through present recapitalization proposals, the progress of the country could leave the Canadian National Railways with such large apparent surplus earnings as to impair the competitive position of the Canadian Pacific Railway. In any such unequal competition the ultimate outcome would be clear. The country would again find itself saddled with another railway enterprise which could not carry the economic costs and the financial expenses of its operation. For the taxpayers of Canada this possibility must now dictate a policy of extreme caution.

In summary, I have been contending that in examining

the recapitalization proposals, first things should come first, because what might seem at first glance to be the troubles of the Canadian National Railways may not be the real trouble at all. If the financial position is to be recast, it should be done after making proper allowance for the fact that the position of that railway can be substantially improved by the correction of the imbalance between rates and costs and by the long-term growth of Canada. Anything that is to be done should be done with a view to protecting the long-term interests of the Canadian taxpayers.

(Page 20825 follows)

Q. Thank you, Mr. Elliott.

EXAMINATION BY MR. COVERT:

Q. Would you turn to page 4 of your submission, Mr. Elliott. I just wanted you to look at the middle paragraph; it is the third from the bottom, just about exactly in the middle of the page. You use the expression "total costs". You say:

> "I think it is equally true in the case of a public enterprise that the business revenues should support their total costs and, until this result is achieved",

and so on. I wanted to find out just what you meant there by total costs in the case of a public enterprise.

A. Total costs in the case of a public enterprise, I would include the prime operating costs, plus the financial expenses for administration and the charges on debt and capitalization. That would be the total costs, in my view. I draw a distinction in my mind which perhaps should be mentioned now as between the prime operating costs, labour and materials, and so forth, on the one hand, and financial expenses on the other.

Q. Do you include in there, in the word "total costs", return on equity capital?

A. Yes, the return on the investment made.

Q. Regardless of whether it is funded debt or equity capital?

A. In my view there should be a return, if earned, on equity capital; that every investment made by the government should carry a return -- should earn a return -- may I express it that way?

Q. Then on the same page, in the next paragraph, I just wanted to find out about the sentence which you

start with the number 3. You start the paragraph by saying:

"The criteria for acceptance, modification or reduction of the recapitalization plan, it seems to me, fall squarely on three points,"

and the third one you say is

"whether it retains fair competitive standards of operation and finance as between the two transcontinental railways."

THE CHAIRMAN: What is the meaning of it? It reads:

"The criteria for acceptance, modification or reduction of the recapitalization plan, it seems to me, fall squarely on three points,"

and then it says:

"whether it" -- that is the plan, is it? -- "retains fair competitive standards of operation and finance as between the two transcontinental railways."

MR. COVERT: That is right.

THE CHAIRMAN: Whether this plan as submitted?

MR. COVERT: That is right.

Q. Now, I was going to first suggest to you this: ordinarily if the Canadian National were a private enterprise the recapitalization plan I suppose perhaps would be none of the business of the Canadian Pacific; is that so?

A. It would be a matter of concern, I would take it, for the Canadian Pacific if they are engaged in competition, and the authority that would determine the legitimacy of the recapitalization for a private concern

and bankruptcy proceedings or otherwise would presumably have the position of the competitor in mind, so that I would not like to go so far as to say that it would be none of their business. It would be a matter of concern, I take it.

THE CHAIRMAN: It would be a matter of concern to the shareholders, of course, and the security holders, would it not?

MR. COVERT: Q. I would have thought that if the Canadian National were a privately owned road and they had to go through reorganization proceedings because they were unable to pay their funded debt, the matter would have been -- first, you would have to have meetings of bondholders or creditors or whoever they might be, and then the scheme would be submitted to the approval of some court to approve the plan on the basis that it was fair to all the parties concerned, but that an outside company would not be able to come in and protest; would not that be the situation?

A. I would imagine that that would be the situation, that they would have no controlling interest in the disposition of the company's difficulties.

MR. O'DONNELL: They could not even get into the meeting of shareholders or bondholders, as far as that is concerned.

THE CHAIRMAN: Supposing that the Canadian Pacific Railway were desirous of taking such measures today, then we could follow up on that.

MR. COVERT: That would be my understanding, that a competitor in the field would not be able to object to the proposal.

Q. Would not that be so?

A. Well, I am not a lawyer, but I would take it --

Q. You have been with Ames & Company for a long while, and I thought perhaps you --

A. I would say that they would have no controlling position in the disposition of the company's difficulties, but it would be a matter of interest to them what the final adjudication was.

Q. Then what I wanted to find out was, what in your view --

THE CHAIRMAN: Pardon me a moment, perhaps there is this: are there any provisions either in the Railway Act or in the Companies Act or elsewhere concerning what steps must be taken for the reduction of a railway's capital, for instance?

MR. COVERT: My recollection, sir, is -- but, with the railway counsel here, they can perhaps give you a better answer -- that our Railway Act does not contain any such provisions. Is that not right, Mr. Friel?

MR. FRAWLEY: The Companies Creditors Arrangement Act.

MR. COVERT: Oh, yes. Whether or not that applies--

THE CHAIRMAN: Is it the Dominion Companies Act, or is there not an act by itself which deals with that?

MR. COVERT: Yes, there are several ways it might occur, I think, in Canada. You might have bankruptcy proceedings, you might proceed under the Companies Creditors Arrangement Act, and then there is a provision under the Dominion Companies Act; but in none of those --

THE CHAIRMAN: All these are court proceedings.

MR. COVERT: Yes.

THE CHAIRMAN: And the only parties who have voice there are those who are interested in the company.

MR. CARSON: I have sent out for the Exchequer Court Act, because there was some suggestion by someone that there might be something in that Act. Mr. Spence draws my attention to the provision of the Dominion Railway Act relating to insolvent companies, commencing at Section 155. It is the Railway Act, Revised Statutes of Canada, 1927, Chapter 170, and Section 155 is the first section of that group of sections.

THE CHAIRMAN: Insolvent companies?

MR. CARSON: Insolvent companies.

THE CHAIRMAN: "Scheme may be filed in Exchequer Court. May affect shareholders and capital. Declaration to be filed. Affidavits. Court may restrain action. Notice of filing."

Is there any provision in that chapter of the Act for anybody else having access to the court than those who are directly concerned in the company?

MR. CARSON: I am just reading it.

MR. O'DONNELL: Bondholders, debenture holders, charge holders, shareholders preference and ordinary.

THE CHAIRMAN: "No assent required from class not interested."

That means certain shareholders.

MR. CARSON: Section 156, subsection 2, deals with the position of a company that is a lessee of a railway.

1. Mr.Elliott,

THE CHAIRMAN: A matter of the leasing company.

MR. CARSON: Yes.

THE CHAIRMAN: Well, I think we can take it, can we not, that the persons interested must have an interest -- creditors, or shareholders?

MR. CARSON: That is the general underlying principle of legislation of this kind, I think.

MR. COVERT: Yes.

THE CHAIRMAN: Other individuals of other companies could not come in on proceedings of that sort -- I suppose not. If you find that they can, let me know.

MR. CARSON: If I find they can, we will let your lordship know, but I am just looking at it for the first time in recent times.

MR. COVERT: Q. What I wanted to find out, Mr. Elliott, from you, is what reasons you advance -- perhaps I will put this first: Do you say there is a difference when one is a government road and one is a private enterprise -- a difference in viewpoint or a difference in the approach to that problem?

A. Do you mean from the standpoint of the C.P.R.

Q. Is it because the road that is seeking to be reorganized is a government road, that that gives the other road the right to come in and ---

A. Well, I would take it that the difference fundamentally that is in my mind, Mr. Covert, is this, that a very large public investment, including taxpayers' funds, has been made in this enterprise known as the Canadian National Railways. From the same point of my philosophy that investment is justified in earning a return, and if a recapitalization is proposed which

deprives the taxpayer of access to a just return on the investment that has been made, then it becomes a matter of very great moment to the taxpayers of this country. That is the generality of what I have in mind.

Q. Could I pursue it a little further with you this way: Supposing that this had been suggested, that the C.N.R. has asked for a recapitalization which amounts to approximately a billion dollars; now, they say that that will enable them to just break even. It has been suggested that they should have a surplus of about $15 million a year, which would mean that they have not gone far enough, they should have asked for an adjustment of about $1,500,000. Now, if that were the case, if they asked for a complete wiping out of the funded debt and extra cash besides the $300,000,000, does the amount involved give the taxpayer or the competitor an additional right to come in, or a stronger ground on which to come in, and attack the proposal? Is that it?

A. Well, I am not sure that I understand your question entirely. The attitude that I would have would be this, that this Commission should endeavour, and presumably is endeavouring, to form some estimate of the earning power of the Canadian National enterprise in the future under varying conditions that can be visualized, that will be earned over and above the operating charges and will be available for fixed charges. If some substantial sum is in sight as a result of rising traffic, as a result of rate changes, as a result of economies in operation, if there is some substantial method of raising income in sight available for fixed charges, then it would be my view that the taxpayer would be taking a very short-sighted view in

not resisting a complete recapitalization of the indebtedness to the Government such as is now proposed. Do I make myself clear, and am I answering your question -- because I am very anxious to do so.

Q. I think perhaps you have partially answered it. What I really am trying to get down to is this: Do you say that any recapitalization must in the final analysis, depend on whether or not the result of it shows or xxx has some relationship to the true cost of operating the road capitalized?

A. Any recapitalization should come, in my opinion, after there is some indication that this imbalance which follows every war has been corrected. Then you will have some knowledge of what the net operating income of the Canadian National may be. It seems to me premature to consider this matter at this moment, and that for various reasons, one reason being that the imbalance is not yet corrected, that there are rate determinations, there are prospective changes in the character and the volume of traffic, there are changes in the dieselization programme, and other mechanical and automatic contrivances that are only now becoming available; that all of these should be considered, and that at some point of time -- maybe it can be done today, and if now, so much the better, but at some point of time we get a knowledge of what are the prospective variations from year to year in the net operating revenues of the Canadian National Railways. If the amount of net operating revenue in prospect is very small, presumably some recapitalization can be contemplated. If, on the other hand, the prospects of net operating revenues are going to be large, then a lesser recapitalization can be contemplated. But I do not want twenty or twenty-five years from now my

children and my grandchildren saying, we made a bad deal back in 1950, we did not take account of the changes that have now in historical perspective become evident to all of us.

Q. Then you tie the recapitalization entirely into the earning power of the railroad?

A. That is right.

Q. And you say that that is the only basis upon which a recapitalization should be made

A. That is the basis that appeals to me.

Q. You see, in Item No. 3 it seems to depend on the retention of fair competitive standards of operation and finance as between the two systems; perhaps if you do that you may be taking it away from the mere possible operating aspects, operating income aspect of the C.N.R.

A. No; if the C.N.R. is able to earn and pay a return on the taxpayers' investment, I take the position that that they have a perfectly justifiable right to use any surplus for any purposes that may be required. Nothing would please me more as a citizen of Canada than to be able to say we have made a wonderful investment in the Canadian National Railways; they have earned the charges, and we have a surplus, after meeting the taxpayers' requirements, to turn back into the efficient operation of the property. Nothing would please me more.

Q. May I put it to you this way, then: On that basis, could you say that if the Canadian National Railways' capital structure consisted entirely of income bonds -- entirely of income bonds -- that would solve the problem, from your point of view

A. The situation there is that the taxpayer is making a concession from a fixed, inflexible rate of interest into a contingent interest position.

MR. CARSON: Q. Do you say fixed and inflexible?

A. Fixed and inflexible interest as presently constituted, into a contingent interest position on the income bonds. Now, if there are good reasons for that, as a matter of principle I would not have any particular objection; but if in the future the Canadian National can earn the fixed interest charges on the investment that has been made, I would see no reason to change them into income bonds. If they cannot, then I would try to protect the taxpayers' interest by making some concessions that I think would not be prejudicial to the interests of the taxpayers in the sense that when eernings were made, the taxpayer would be recouped, and there is quite possibly considerable justification from the standpoint of the Canadian National Railways,in the sense that they would have this improvement in the morale of their officers and employees.

MR. COVERT: Q. That seems to be the main reason for the asking of the recapitalization, to put them in a position that they are not always showing deficits, and I was suggesting, if you have income bonds as their entire capital, then the Government, or through the Government the taxpayer, gets all that is coming to him, and at the same time they do not have to show deficits.

A. When it is earned?

Q. Yes. But you say that there should still be this fixed funded debt or the funded debt yielding a fixed rate of return until, I think you say, the imbalance in rates is corrected?

A. Yes, but I would not have any inflexible attitude in the matter. The only position I am taking is that the taxpayer is giving up some rights, when he gives

up those claims to a fixed annual rate of return, and when he gives that up he is accepting a contingent return, and he does that only for good cause.

THE CHAIRMAN: He is giving it up to whom?

MR. COVERT: That is it exactly. He is giving it up to the government -- he gives it up to himself, perhaps.

THE WITNESS: Yes.

MR. COVERT: Then there must be --

THE WITNESS: But he has to recoup it out of the revenues of the railroad, and those are supported by the shippers of the country.

MR. COVERT: Q. Could you pursue that a little further now? For instance, supposing the rates paid by the shipper were not affected by the recapitalization, then does it have any effect from the point of view that you have just discussed?

A. No; under the traffic conditions that are prevailing and the rates that are charged, there will either be or not be a net operating income. Now, if the recapitalization does not go through there will be a deficit carried through on the year's operations. If, on the other hand, income bonds are substituted for your fixed interest-bearing debt, it will be merely a contingent interest position that the taxpayers will have. They will have no claim.

Q. What I wanted to find out, Mr. Elliott, was whether or not you really did not come back to this position too, that the recapitalization may possibly affect the freight rate structure?

A. In its present form. If there is to be no fixed interest charge payable to the Government, either by way of income bonds or by the present form of

indebtedness, then there is a danger that under good operating conditions the Canadian National Railways would realize such a large surplus as to present a possibility of a change in the rate structure.

Q. Now would you turn to page 5, Mr. Elliott, the penultimate paragraph, where you say:

> "If, on the other hand, the Government of Canada should be asked, in effect, to restate its losses and advances by the exchange of Canadian National Railways obligations for a form of equity capital, it is only fair and just to recognize that more than mere book-keeping entries are involved and that the weight of debt should not be removed until every effort has been made to carry it and support it."

Now, I wanted you to elaborate on that, first with respect to --

THE CHAIRMAN: I think we had better take an interval now.

(Recess)

(Page 20845 follows)

MR. CARSON: Your lordship asked me to let you know if I found anything in those Sections of the Railway Act that permitted other persons to come in in such proceedings.

Your lordship will find a provision in Section 157, and that Section provides that:

> "If, at any time within three months after the filing of the scheme (that is, the shceme or arrangement or compromise) or within such extended time as the Exchequer Court, from time to time thinks fit to allow, the Directors of the Company consider the scheme to be assented to, as by this Act required (that is, after they have held the necessary meetings and had the necessary votes and so on) they may apply to the Exchequeir Court by petition in a summary way for confirmation of the scheme.
>
> 2. Notice of any such application shall be published in the Canada Gazette".

The purpose of that would be to see that there was notice given to everybody in Canada in the official way, and then:

> "3. The Court, after hearing the directors and any creditors, shareholders or other persons whom it thinks entitled to be heard on the application, may confirm the scheme, if satisfied that the scheme has been assented to, as required by this Act, within three months...."

and so on.

Now, of course, your lordship will remember that in those corporate organizations normally there are perhaps four general groups that have to meet and vote on the scheme - first, the bond holders who have the preferred position and then the creditors (they have to

have a meeting) and then, the preferred stockholders meet and the ordinary stockholders meet as a separate class and the scheme has to receive assent from all the holders before that comes to Court. But through this course of meetings, each of these groups is fighting for what they can get and there is no one fights harder than the normal stockholder to see that in the reorganization he gets everything he can get, so there is that safeguard where a private railway enterprise would be going through a reorganization plan and you put the question:- "Would the Canadian Pacific be here?"

Now, it seems to me - this is something that perhaps might not happen but it might be in Canada that we had another private enterprise of a comparable kind to the Canadian Pacific and they were perhaps trying to negotiate such a reorganization scheme as this and suppose some American group or Russian group or Japanese group came in with money and were ready to buy the thing back - what might be regarded as a syndicate, it might well be that the court would say in circumstances like that: "We want to hear - we think that the person who is entitled to be heard here is the other railway company."

THE CHAIRMAN: You have in mind a foreign group prepared to buy?

MR. CARSON: Yes, coming in.

THE CHAIRMAN: You think they might be admitted then under the designation of "other persons whom it thinks entitled to be here"?

MR. CARSON: Yes, the court would have to think; the court would have to decide that in the circumstances they were entitled to be here.

THE CHAIRMAN: Are you sure they would want to be here?

MR. CARSON: I am not at all sure they would want to be here.

THE CHAIRMAN: It might be the other way around.

MR. CARSON: I do think it is an unlikely eventuality because of what happens before you go into court, that is, all these different groups in connection with the buying group or the buying syndicate fighting for everything they can get. If a scheme is put forward by a syndicate or promoters who are going to buy, they have four groups to deal with as a general rule and it is a fair chance that if you could get the requested majority from each of those competing groups, that you have got something that is likely to be acceptable.

All I am trying to do is point to the Section in answer to your lordship. I am not trying to say these things are likely to happen.

THE CHAIRMAN: You are trying to exhaust the possibilities?

MR. CARSON: Yes.

THE CHAIRMAN: But do you, in the long run, really think there are other persons who are neither shareholders or creditors who are entitled to have the right to come in?

MR. CARSON: Well, I do not think that that section would be construed -- "entitled to be here" as meaning in a legal sense that there is some contract which enables them to come in, but they have got some interest in the project or the scheme or proposal and the court could say: 'Well now, we think they are

entitled to be here."

THE CHAIRMAN: That is it -- the court must saa they have some right there.

MR. CARSON: Oh yes, the court must say. I am not suggesting someone could walk in before his voice is heard.

THE CHAIRMAN: Can you imagine another company coming along and saying: "We are entitled because if you recognize this organization according to the scheme and even though you do satisfy all the creditors and all the shareholders, the result would be that you would set upa company then that would be able to compete with us on an unfair basis?"

MR. CARSON: I think that is an unlikely eventuality, my lord, because of the situation I pointed to because before it ever reaches that stage those who are to become the new equity shareholders or the present shareholders who will have perhaps a diluted equity wil vote at their meetings.

THE CHAIRMAN: I am imagine though that if, for instance (God forbid) the Canadian Pacific should ever be in the position of these kinds of proceedings I cannot imagine the court hearing the Canadian National coming in and saying: "Don't do this thing; it will hurt us too".

MR. CARSON: I do not think so. Your lordship will appreciate I am only trying to answer your question.

THE CHAIRMAN: Yes, you have helped me considerably.

MR. COVERT: I think I had just started to ask you, Mr. Elliott, about the penultimate paragraph on page 5 where you were saying that you recognized that

"More than mere bookkeeping entries are involved." Now I would like you to consider that apart from the question of the $300 million indebtedness.

THE CHAIRMAN: You are referring to the next to the last paragraph?

MR. COVERT: Yes, Mr. Chairman. Do you say that in reality there are more than bookkeeping entries involved apart from that item?

THE WITNESS: Well, there is a change. If the present plan were put into effect, there would be no change in the total amount of stated capital invested by the government. The change would not be in the amount; it would be in the change in the form of that capital. Instead of being an obligation carrying a fixed annual rate of return payable as a legal obligation by the Canadian National Railways, it would be represented by a commensurate amount of equity capital which I judge would carry no such obligation on the part of the Canadian National Railways.

In that sense, there would be more than a bookkeeping entry involved.

Q. Now, what I wanted to come to is, supposing they were income bonds, would not the Government or the tax payer be in exactly the same position as he is today because if the Canadian National cannot meet the fixed charges on the bonds due to the Government, it just does not do it anyway? There is not accumulation. Is not that correct?

A. That is correct. The practical difference so far as the taxpayer is concerned, I would judge, would be negligible, but there would be no recurring deficit added to the balance sheet of the Canadian National Railway, but in either case the

Government of Canada would collect what it could collect in view of the net operating income of the Canadian National.

Q. Now then, on page 6 in the last paragraph and just about the middle of it, you are referring there to the $300 million item. You say:-

"As I understand the proposal, this fund would be beyond the control of Parliament..."

and so on. Now, I think perhaps that is altered in view of what was said this morning?

A. May I express it this way, that in the original proposal, as I read it, by Mr. Donald Gordon, there was a statement to the effect that the $300 million would be set up as a capital fund of the Canadian National Railways and there were no allusions to any safeguards as to how that might be used.

Now, this morning my understanding is that Mr. O'Donnell has stated it as his opinion that when, as and if that agreement is made, to place this $300 million at the disposal of the Canadian National Railways, that it will be hedged about by the same -- I think he called them -- fetters and restrictions as presently existing in respect of the application of the Canadian National Railway for capital funds. To that extent, my original understanding has been modified.

MR. O'DONNELL: I said that was the law as I understood it.

MR. COVERT: Now then, this may not be a fair question, Mr. Elliott, but I just wanted to ask it and if you do not feel that you can answer it, all right, but on page 7, in the first full paragraph and about the fifth line down, there you say:-

"If, after correction of the imbalance"..."

and so on

"....the Canadian Natinnal Railways can justify a realistic recapitalization of a portion of $760 million ...."

could you suggest what you would regard as a "realistic recapitalization?"

A. A capitalization that can be carried by the prospective net operating income of the Canadian National Railways over a term of years.

Q. Then, could I ask you this; do you refer there to the type of recapitalization that there would be if this company were a private enterprise and they became in default on their bond interest and they went through the usual procedure and arrived at a recapitalization that would, in the final analysis, enable them to carry on without applying for another recapitalization? Is that what you mean?

A. Yes, I think the principle involved would be similar, that in both cases, in both the case of a private enterprise and of a public enterprise, an investment has been made in assets which may or may not be as productive as was expected. The productiveness of the assets will be indicated over a period of time by the earning results achieved and from my standpoint those earnings should support by way of return the investment that has been made.

Now, if, in the case of a private enterprise, there are disappointments and recapitalization is necessary then recapitalization takes place. Similarly, if the prospect is the same in a public enterprise, that it is in a hopeless position, that it will not earn a return on the fixed interest-bearing capitalization, then, in my opinion,

recapitalization should take place to bring it in line with the realistic earning power as appraised.

Q. And I was going to ask you, Mr. Elliott, if you have a railway which the owner, the Government, is going to say to:- "Now, you must take in railways like the Temiscouata and the Newfoundland Railway", is there any feasible recapitalization, in your opinion, other than income bonds?

A. Again, as a matter of principle, I would perhaps differ somewhat from Mr. Norman. On strict grounds I would maintain the position that the revenues of the operation should support all of the operations including the Temiscouata and the unremunerative lines.

Now, that is the principle. If, on the other hand, it is found more expedient from the standpoint of Government policy that an exception to that principle should be exercised, then those parts of the line are withdrawn and their losses segregated and brought and sustained directly by the taxpayer rather than by the shippers, but I hold with the view that the customers of an enterprise should support it.

Now, as far as the income bonds are concerned ---

Q. Before you leave that, when you say "the customers should support it" bearing in mind the position at the time the Government took over these bankrupt railroads, and bearing in mind that at the time the Government decided, rightly or wrongly, that they should be taken over and operated by the state -- as I say, bearing those things in mind, it is conceivable that perhaps they could never be operated at rates that would enable those railways to pay charges on the amount invested in the railway?

A. Well, I would take it as a matter of fact, Mr. Covert, not only in railroads but in many large business enterprises that there is no uniformity in the profits realized from all types of service or from all the types of products that are produced. That is a part of the business game. That is a chance that is taken, and I think it would be a rarity based on my experience that any large business operates without either part of that operation and either product and either service would be uniformly profitable. Similarly, in the case of a railroad operation.

Presumably, both the Canadian Pacific Railway and the Canadian National Railways have lines that are more remunerative than other lines and have certain types of traffic that are more remunerative than other types of traffic and may in fact, both of them presumably, have lines and types of traffic that are not remunerative at all. So that, in viewing the enterprise as a whole and from a strict standpoint it is my view that the users of the enterprise must support its cost including all financial expenses. Is that a complete answer to what you had in mind?

Q. Yes, I wanted your views on that and you have given them. Now then, on the top of page 8, I think the paragraph begins at the bottom of page 7, you say:-

> "The potential earning power of the vast Canadian National Railways System allocated according to ordinary commercial standards as well as the maintenance of the competitive position and financial integrity of the Canadian Pacific Railway call for a far-sighted and just disposition of surplus income after payment of fixed charges."

Now, I wonder if you could explain exactly what you have in mind there?

A. Well, assuming that with the growth of the country the present fears as to the earning power of the Canadian Natinnal Railways are not justified, that as in so many other cases where debt has been reduced, the consequence is that economic conditions produce a much better earning situation than was originally contemplated. We have examples of that in this country where debt of a certain character was once regarded as insupportable. But, in the light of subsequent economic developments, it becomes entirely supportable, and over and above the fixed charges, surplus earnings are realized.

I think the point that I am making here is that in contradistinction to the present plan which in fact eliminates as an obligation, as an annual obligation, of the Canadian National Railways the payment of any fixed interest return, that ordinary accounting standards, commercial accounting standards, would require that the return on the investment of whatever form of capital it is should be made and, after that point and having regard to the fact that I have also suggested that taxes be paid, that they would be within the disposition of the Directors of the Canadian National Railways as to what use should be made of any surplus. That is all that I had in mind there.

Q. Now then, at the bottom of that page, there was another thing I wanted to find out what you meant by. That is about ten lines up from the bottom. You say:-

"If, on these bases, the Canadian National Railways should become self-supporting then, as

in ordinary commercial practice, surplus earnings over and above these requirements would be used at the discretion of the Board of Directors of the Canadian National Railways".

I think that is what you have just said up above here, and I just wanted to know what you meant by the words "these requirements" here. Perhaps it is clear. I just wanted to find out what you thought the requirements of the Canadian National might be.

A. Well, the requirements on the bases that I have suggested would be an annual franchise tax, that there should be a return when earned on income bonds.

Now, at that point (that is quite a step to take) I have simply said that over and beyond the requirements there is a further investment of $774 million. There has been no suggestion, so far as I am aware, from any source as to what returns should be paid, if any, on that equity stock, and I am not here suggesting a return that might be paid on that stock.

MR. CARSON: You are not suggesting a rate?

A. No, and the bases then to which I have made a specific allusion are the taxes and the return on the income bonds but with the warning , that there is a further equity of $774 million whose claim in the event of bountiful earning power should not be overlooked.

MR . COVERT: I wondered if besides any of those things you had thought of this something to come and go on and, if so on what basis?

A. Well, I would have an open mind at this stage on that subject. I would think that the taxes should be paid and the interest on the income bonds should be paid. At that point, one could look further into the

situation in the light of prospective earnings development. At that point, it may be the part of wisdom to ignore the claim of the $774,000,000 in order that the Canadian National Railways be put in possession of a surplus fund at that point -- pay half of the surplus at that time as a return on the $774,000,000 of equity and leave half to the discretion of the Board of Directors of the Canadian National Railways.

I would not like to express any final view on that, but some such arrangement would seem to me not to be too far from ordinary commercial practice.

Q. Now, there are just two more questions dealing with page 9. In the first complete paragraph about five lines down, you use the words "large apparent surplus...." I just wondered if you wanted to explain that in any way. You refer to "the gravest danger is that, after correcting the imbalance between rates and costs and after accepting losses through present recapitalization proposals, the progress of the country could leave the Canadian National Railways with such large apparent surplus earnings as to impair the competitive position of the Canadian Pacific Railway."

THE CHAIRMAN: Is that on the supposition that this plan is accepted?

MR. COVERT: Yes, I think that is right, isn't it?

WITNESS: Yes.

MR. COVERT: Q. Do you mean that if they did have a surplus that it is apparent rather than real

A. The meaning of the word "apparent" that I had in mind when I wrote this, was that it would be an apparent surplus arising out of non-payment of the fixed interest charges presently chargeable on the

indebtedness held by the Dominion Government.

Q. Then, do you get back to really saying that any such surplus is not real because proper costs have not been taken into account?

A. No, that a proper financial charge has not been made against the net operating income of the Canadian National on the basis of its present capitalization. Instead of having zero after payment of the interest on the indebtedness held by the Government, if that interest charged is eliminated, then the Canadian National Railways has an apparent surplus of approximately $21 million according to my recollection. It is in that sense that I use the term.

MR. COVERT: That is all I have.

THE CHAIRMAN: Anybody else?

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CROSS-EXAMINATION BY MR. FRAWLEY:-

Q. Mr. Elliott, I notice in two or three or four or five places you use the expression "imbalance between rates and costs". That is a matter of some concern to you. What do you mean exactly by the word "costs" there?

A. The position I see is this, that the net earning power of a railway or, for that purpose, any other business enterprise is the physical volume of its production, whether it is goods or service, multiplied by the price less the costs and expenses and there you have this ability to carry the investment that has been made. The costs in that sense, the imbalance that I have in mind are the primary costs to which I alluded in my replies to Mr. Covert, the costs involved in wages, materials and

physical requirements of the railroad.

Q. The costs that are sometimes referred to as the "costs above the line" -- working expenses?

A. The working expenses.

Q. Not the financial requirements?

A. Not the financial requirements.

Q. And you speak then of the imbalance between rates and costs and you say that that must first take place?

A. In my opinion.

Q. And another way of putting that is, that the freight rates must overcome the costs, the wages and material costs?

A. No, sir, I have not said that.

Q. Well, when you speak about correcting the imbalance then, Mr. Elliott, what do you mean?

A. To correct the imbalance by reference to the factors I meationed, by striving to get as much volume as you can as every good business should, then by striving to get as good a price on your rates as you can get, by striving through mechanization and dieselization and all these other things to reduce your costs and the point I am making -- the freight rate is only one factor.

Q. Then, to the extent that it is only one, this increase in freight rates would be at least one factor in the correction of the imbalance?

A. I assume so.

Q. And if it should be that as a result of the wage bill which is presently pending negotiations, a further freight rate is required -- say I put it this way, that the wage bill of the railways goes up very very considerably, do you anticipate in your scheme

of things that that must be corrected in part at least by a freight rate increase?

A. I would take it that a freight rate increase with a change in the freight rate structure might be quite as justifiable a source of correction of the imbalance as these other factors and I say that on the basis of the experience of past years that we have all gone through -- we have all gone through these periods of periodical instability of prices and goods -- none of us like to see the increase come along, particularly when these institutional increases come on top of a rise in the price of butter and eggs and a lot of other things. We do not like to see those things come along at this particular time. Nevertheless, we have found that they are absolutely essential.

Q. What is an institutional rate increase?

A. An increase in electric power rates and telephone rates and railroad rates.

Q. If the railways of Canada should be presented with a $90 million wage bill, an increase of $90 million in its wage bill, you would not expect much of that to be picked up by dieselization or other economies in operation?

A. I cannot answer that question.

Q. Would you expect a great deal of it to be?

A. I would expect a part of it.

Q. But where would you expect, if it is to come, the most of it would have to come from?

A. I do not have a familiarity with the constituents of railway operation to answer that question.

Q. Would not it have to come from freight rate increases, Mr. Elliott, if the wage bill went up $90 million?

A. In part, I would certainly think so.

Q. Almost wholly?

A. That I cannot say.

Q. Now then, Mr. Elliott, as a student of Canadian affairs, would you advocate increasing the freight rates in Canada to make up a $90 million wage bill?

A. Well, I think I have said that the imbalance has to be corrected in one way or another, and if thatis part of the corrective process, I am afraid I would have to advocate that as part of the corrective process, but I would regard it -- I would regard it as any business man regards the necessity of raising the price of his product; that is not the way you widen your market.

Q. And you would say that even though you knew and understood that it would have to go on non-competitive traffic?

A. Well, again I would be out of my ken.

Q. Well, your camp is out of the - -

A. Ken -- I would be out of my ken.

Q. Your ken is the investment banking field?

A. In part.

Q. And the study of general social and economic financial conditions?

A. In part.

Q. You did some of that somewhat west of the Great Lakes at one time?

A. Yes.

Q. Now, you say on page 7 that:-

"It would seem to me to be obvious that the Government of Canada, which, in effect, means the taxpayers of Canada, should not

deprive itself of any possible benefits of its concessions to the Canadian National Railways". Has your thinking, Mr. Elliott, included the possibility that the Government of Canada on behalf of the taxpayers of Canada might think that one of the possible effects of the concessions to the Canadian National in this capitalization scheme might be some amelioration of the freight rate structure?

THE CHAIRMAN: Pardon me, would you give me that reference again?

MR. FRAWLEY: It is on page 7, sir, in the second full paragraph:-

"It would seem to me to be obvious that the Government of Canada, which, in effect, means the taxpayers of Canada, should not deprive itself of any possible benefits of its concessions to the Canadian National Railways."

And my question of you was, Mr. Elliott, as you thought through this problem whether or not it came to your mind that the Government of Canada on behalf of the people of Canada might think that one of the possible benefits of the concessions in this scheme might be some amelioration of the freight rate structure?

A. That is quite possible that that occurred in my thinking. Whether it has occurred to the Government of C nada, I do not know, but it has occurred in my thinking.

Q. You think it might very well occur to the Government of Canada?

A. Conceivably. I cannot speak of that.

Q. But in the way you have been thinking of this matter it might conceivably be one of the more important

things
/in the mind of the Government of Canada?

A. I would think the Government of Canada would be thinking of all its aspects.

Q. And one way of improving the freight rate structure as a quid pro quo would be to ask the Canadian National to provide freight rate service at cost without profit to its owners, namely, the people of Canada. What do you think of that?

A. Well, if the Canadian National alone were to be considered in the matter, and if the Government of Canada wanted amelioration for the shippers of this country rather than the taxpayers and only one railway was involved, because they might ask it, I would not think it would be a very wise way of handling the situation.

Q. You think that the wiser way, I think one can fairly conclude from your general study and statement -- that the wiser way would be to keep the private road the measure or guide of the freight rate structure?

A. As a taxpayer, I feel so.

Q. And then, the question comes down, I suppose, Mr. Elliott, well at what cost to the people of Canada must the Canadian Pacific be kept the measure or guide? Is that a fair question? At what cost to the people of Canada must the Canadian Pacific be kept the measure or guide? At what cost to the freight shippers in Canada must the Canadian Pacific be kept the measure or guide?

A. Well, I would think of it in terms of the alternatives, that if you are going to force through your rate regulation -- if you are going to force and recapitalize -- if you are going to force the Canadian Pacific Railway to the wall and I am going to have to

support this loss in order to have a lower freight rate structure, as a taxpayer I am not interested.

Q. That means then, that to save the Canadian Pacific and to keep it not only in efficient service but as a yardstick, as a measure or guide for the fixing and determination of freight rates -- to do that I ask you whether or not some concession to the taxpayers is in order in view of the fact that we will reject this capitalization scheme as you in effect propose that it should be rejected?

A. What concession could be made to the taxpayer?

Q. I am wondering if you have anything.

THE CHAIRMAN: Do you mean concessions by the Canadian Pacific?

MR. FRAWLEY: By the Canadian Pacific -- yes.

THE CHAIRMAN: Now, what is the basis of this? Is this on the hypothesis that the C nadian Pacific must be kept going?

MR. FRAWLEY: Must be kept the yardstick for the fixing of freight rates.

THE CHAIRMAN: Before you get to anything else, must be kept going?

MR. FRAWLEY: Oh, yes, obviously must be kept from bankruptcy, yes. In the course of my questioning of the witness I am agreeing to that life, so I am asking him, my lord.

THE CHAIRMAN: Then, having regard to that position, you wish to know, do you, what concession the railway is prepared to make to the people? They could not make any concession beyond one which would prevent it from living?

MR. FRAWLEY: Yes, that is true, consistent with its continuing to live and in return for having the Canadian National proposal rejected, then what consideration is the Canadian Pacific willing to give? That is my question.

THE CHAIRMAN: We had better hear the answer tomorrow morning.

---At 4:45 p.m. the Commission adjourned to meet again at 10:30 a.m. on Thursday, April 27th, 1950.